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JU 11.7/2: 1986-112

T. C. Memo. 1986-112

UNITED STATES TAX COURT

GLORIA HULL, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

BILLY HULL, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 2691-78,
2692-78.

Filed March 24, 1986.

H. Wayne Grant, for the petitioners.

John L. Hopkins, for the respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

SCOTT, Judge: Respondent determined deficiencies in petitioners' income tax in the amounts of $17,329.57, $27,784.23 and $4,922.83 for the taxable years 1968, 1969 and 1970, respectively, and additions to tax under section 6653(b)[1] in the amounts of $8,664.79, $14,611.72 and $2,461.42 for these respective years. By order entered September 30, 1982, this Court granted respondent's motion for partial summary judgment and determined that each of petitioners is collaterally estopped from denying liability for the additions to tax under section 6653(b) for the taxable years 1968 and 1969 by reason of being convicted for willfully and knowingly attempting to evade and defeat income taxes for these years in violation of secton 7201. Respondent on brief has conceded that there is no addition to tax for fraud for the year 1970 and that the return for that year was not false and fraudulent. Respondent further concedes that by reason of this concession the statute of limitations bars the assessment and collection of any tax for the year 1970. By reason of the order of this Court granting respndent's motion for partial summary judgment and respondent's concession as to the year 1970, the only issue remaining for decision is the amount by which petitioners

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1 Unless otherwise stated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect during the years here in issue.

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understated their taxable income for each of the years 1968 and 1969.

FINDINGS OF FACT

Petitioners, husband and wife during the years 1968 and 1969, filed joint Federal income tax returns for these years with the Director, Southeast Service Center, Chamblee, Georgia. At the time of the filing of her petition in this case, Gloria Hul l resided in Rossville, Georgia, and at the time of the filing of his petition in this case, Billy Hull resided at Deberry Correctional Institute, Nashville, Tennessee.

Petitioners were married in 1951 while they were juniors in high school. During their senior year in high school, Gloria Hull worked on the second shift at Chattanooga Glass Company as well as attending school. When they finished high school, Billy Hull worked at the Peerless Woolen Mills for a year or two until he entered college in 1953 or 1954 at Tennessee Tech in Cookeville, Tennessee. While Billy Hull attended Tennessee Tech, Gloria Hull continued to work. She was employed at Airland Carpet Mill during the first years he was in college and later moved to Cookeville where she worked for the telephone company.

Billy Hull graduated from Tennessee Tech in 1958 or 1959 and moved back to Rossville, Georgia, where he went to work at Muller Company, a foundry, as a sand lab technician. Gloria Hull did not work for approximately 1-1/2 to 2 years

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beginning in 1958 at the time of the birth of her first child. She returned to work at Riviara Carpet Mill where she continued to work until sometime in 1962 and then ceased working for 2 years after the birth of her younger child. Thereafter, she went to work at Concrete Forms. Prior to and during the time Billy Hull was working for Muller Company, he from time to time worked at gymnasiums or spas.

In 1967, Billy Hull began operation of a go-go club. He continued to work at Muller Company for approximately 6 months after opening this club but later ceased to work at Muller Company and devoted his full time to the club except for working from time to time at two gymnasiums. The go-go club consisted of a room known as the Lion's Den and another one known as the Castaways. After Billy Hull began operation of the go-go club, Gloria Hull began to work there in the evenings and after approximately 6 months she left her employment with Concrete Forms and began to work full-time at the go-go club. She worked as the evening cashier and did such things as filling cigarette machines during the day as well as keeping the club's books.

Billy Hull's mother, who was living at the time of the trial of this case, was the daughter of Katie Holcomb. Katie Holcomb was a bootlegger. She purchased bootleg whiskey and sold it from her home. Billy Hull helped his grandmother in her bootleg business. He would help her bury whiskey at night and at times he would dig holes for her in

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which to put a barrel to fill with whiskey that would be left there for approximately a year to char. He would also watch at night for his grandmother for the man who brought whiskey to her to come by, and at times he would help her count money which she had taken in from the sale of whiskey. Katie Holcomb dealt in cash in her business.

From time to time, Katie Holcomb gave presents to Billy Hull, Gloria Hull and their children. She gave them such items as automobiles and a boat, as well as clothes. She also from time to time paid bills for them including the cost of sending Billy Hull to college. When the Hull's older son was born in 1958, Katie Holcomb paid the hospital bills. She also paid other medical and hospital bills for Billy and Gloria Hull.

In addition to her daughter, Billy Hull's mother, Mrs. Holcomb had an adopted son, Richard Holcomb. Richard Holcomb and his wife lived in the house with Katie Holcomb. Richard Holcomb also assisted his mother, Katie Holcomb, with her bootleg business. Approximately 14 months prior to her death on February 20, 1969, Katie Holcomb began to show signs of forgetfulness from hardening of the arteries. At approximately this time she was arrested and her son, Richard Holcomb, took over the running of her bootleg whiskey business. After Katie Holcomb was arrested, her mind started to deteriorate. Richard Holcomb would handle obtaining the whiskey, selling the whiskey and taking

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payment for it, but he would give the money he received for the whiskey to his mother, Katie Holcomb. Richard Holcomb would help his mother count the money. Katie Holcomb gave presents to her son Richard. She gave him an automobile and she paid for a number of trips for Richard Holcomb and Billy Hull to Florida. Sometimes they would go to Florida as often as twice a month. In addition to seeing Mrs. Holcomb pay for trips for Billy Hull, Richard Holcomb on one occasion saw Katie Holcomb give money to Billy Hull, but he did not know the amount she gave him.

Katie Holcomb was generous with her friends. She had a friend of longstanding, Emily Curd, who on a number of occasions went on trips with Katie Holcomb. Mrs. Curd lived within three blocks of Mrs. Holcomb for a number of years. Katie Holcomb paid all of the expenses for Mrs. Curd when Mrs. Curd accompanied her on trips to Cuba and to the Bahamas and similar places. She would buy clothes for Mrs. Curd to take on these trips. Mrs. Curd would be given cash by Mrs. Holcomb to purchase clothes and to purchase the plane tickets and the boat tickets. Mrs. Holcomb would carry large quantities of cash with her on the trips on which Mrs. Curd accompanied her but Mrs. Curd did not know the amount of cash she had with her. Mrs. Curd would see Mrs. Holcomb tip lavishly on the trips they went on and she would participate with Mrs. Holcomb in playing bingo or engaging in other forms of gambling while on these trips.

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Mrs. Holcomb often spoke fondly of Billy Hull to Mrs. Curd and would discuss with Mrs. Curd presents she planned to give Billy Hull, such as an antique automobile. Mrs. Curd never saw Mrs. Holcomb give Billy Hull any money.

Mrs. Curd observed Mrs. Holcomb during their trips put items away and not be able to remember where she had put them. At times, she would see Mrs. Holcomb hide money in their hotel room and be unable to remember where she had put the money. She also observed Mrs. Holcomb spend money and then be unable to remember for what she had spent the money.

Approximately a month or a month and a half before her death, Mrs. Holcomb had been in the hospital but had returned to her home. Katie Holcomb died on February 20, 1969. The day before she died, she was rushed to the hospital. Billy Hull thought that the reason for her hospitalization was that a blood vessel had burst in her head. The day following Mrs. Holcomb's hospitalization, the entire family was called to come to the hospital. Billy Hull, his two sisters, Richard Holcomb and Billy Hull's mother were there at the time Mrs. Holcomb died.

Billy Hull pleaded guilty to charges of income tax evasion for the years 1968 and 1969 and Gloria Hull pleaded guilty to aiding and abetting Billy Hull in the evasion of income tax for these years. Billy Hull later pleaded guilty to the charge of accessory before the fact of murder in the first degree.

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Without consideration to any cash, aside from cash in banks, which Billy and Gloria Hull might have had, the folowing schedule shows their assets and liabilities as of December 31, 1967, 1968 and 1969, with the resulting increase in net worth for the years 1968 and 1969:

	12/31/67	12/31/68	12/31/69
ASSETS			
Cash in bank	$ 3,745.10	$ 5,703.28	$ 66,374.63
Automobiles	8,808.54	8,808.54	8,915.39
Corporate stock	-0-	-0-	7,012.50
Real estate	8,316.59	112,150.44	84,917.04
Receivables	-0-	-0-	-0-
Business assets	1,378.30	14,158.17	24,500.74
Prepaid interest	12.75	465.40	885.76
Total Assets	$22,261.28	$141,285.83	$192,606.06
LIABILITIES AND DEPRECIATION RESERVE			
Depreciation reserve	$ 86.14	$ 416.96	$ 4,041.45
Outstanding checks	1,266.10	997.23	551.67
Loans (unpaid balances)	7,707.60	72,320.73	43,710.91
Capital outlay payables	-0-	6,163.12	310.53
Total Liabilities and Depreciation Reserve	$ 9,059.84	$ 79,898.04	$ 48,614.56
NET WORTH	$13,201.44	$ 61,387.79	$143,991.50
Increase in net worth	-0-	$ 48,186.35	$ 82,603.71

The following schedule shows the computation of petitioners' understatement of taxable income for each of the years 1968 and 1969 based upon the above set forth increases in net worth in each of these years, adding thereto petitioners' personal living expenses, subtracting

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therefrom an insurance recovery and capital gains deduction, and making appropriate adjustments for itemized deductions, personal exemptions and taxable income as reported on petitioners' joint returns:

EXPLANATION	1968	1969
Increase in net worth	$ 48,186.35	$ 82,603.71
Plus: Personal living expenses	9,695.00	15,910.37
Less: Insurance recovery	—	7,200.00
Capital gains deduction	—	17,922.20
Adjusted gross income	$ 57,881.35	$ 73,391.88
Less: Itemized deductions	2,369.78	2,876.19
Personal exemptions	2,400.00	2,400.00
Corrected taxable income	$ 53,111.57	$ 68,115.69
Less: Taxable income per joint return	9,749.64	6,850.48
Understatement of taxable income	$ 43,361.93	$ 61,265.21

Respondent explained the adjustments he made in the notice of deficiency by stating that in the absence of adequate records petitioners' taxable income had been computed upon the basis of the increases in net worth during the years 1968 and 1969, with adjustment for nontaxable items of income and for personal and other nondeductible amounts. Petitioners do not question the assets and liabilities as determined by respondent and as set forth above or the computed amounts of their personal living expenses or the nontaxable items as determined by respondent

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in the notice of deficiency. It is petitioners' contention that Billy Hull had cash in a safe deposit box of approximately $35,000 at the end of 1967 which he spent during 1968 and 1969 and that approximately 3 weeks after his grandmother's death on February 20, 1969, in accordance with information she had furnished him on her deathbed, he dug up two glass containers in her yard that contained somewhere around $40,000 or $50,000 which he spent in 1969. It is petitioners' position that proper credit for these amounts of cash have not been allowed in the net worth computation as made by respondent in the notice of deficiency.

OPINION

The issue here is purely factual. Respondent, finding that petitioners' records were inadequate for computation of their taxable income, computed their income for each of the years here in issue on the net worth basis. It is well settled that where a taxpayer's records are inadequate to compute his taxable income, respondent may reconstruct income by any appropriate method, including the net worth method. Holland v. United States, 348 U.S. 121 (1954). Respondent's determination of petitioners' income is presumptively correct and petitioners have the burden of showing error therein. Welch v. Helvering, 290 U.S. 111 (1933). Rule 142, Rules of Practice and Procedure of the United States Tax Court.

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Petitioners stipulated with respondent the assets and liabilities which they had at the end of each of the years 1967, 1968 and 1969, reserving only the right to contend that in addition to those assets and liabilities they had cash which was not considered by respondent. Petitioners made no effort to show any error in respondent's determination of their personal living expenses or nontaxable receipts. Therefore, the issue in this case is only whether petitioners have established that they had cash at December 31, 1967, not included by respondent in the net worth computation and that this cash was used in the acquisition of the assets which they acquired in 1968 and 1969 and that they acquired cash in 1969 from a nontaxable source.

Mrs. Hull testified that Billy Hull carried some cash on his person at all times but she did not know how much. There is nothing in the record to indicate that the amounts of cash carried by Billy Hull on his person would not have been the same or approximately the same at the end of each of the years 1967, 1968 and 1969. In fact, Mrs. Hull's testimony indicates that they were since she referred to his always carrying amounts of cash. The factual issue to be determined is the claim of Billy Hull that he had accumulated in a safe deposit box as of the end of 1967

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approximately $35,000 in cash which he spent in the succeeding 2 years and that after his grandmother's death, in accordance with her deathbed instructions of where to look, he found between $40,000 and $50,000 of buried cash.

The record shows by the testimony of persons other than Billy Hull that his grandmother, Mrs. Holcomb, gave him presents of clothes, automobiles, a boat, and trips to Florida. Mrs. Hull testified that Mrs. Holcomb gave petitioners a house trailer in which to live and later a home near hers and paid some bills for her and her children. However, there is no evidence in the record that any large gifts of money were made by Mrs. Holcomb to Billy Hull aside from the testimony of Billy Hull. There is testimony by Richard Holcomb that on one occasion he saw his grandmother give Billy Hull some money which he thought to be between $200 and $500, but was not certain of the amount. Billy Hull testified that on numerous occasions his grandmother gave him between $200 and $500 and that he would spend some of the money and take the balance and put it in cash with money he saved from his earnings in a safe deposit box. He testified that by the end of 1967 the amount of cash he had put in this box had accumulated to approximately $35,000. We do not believe this testimony.

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The record shows that Mr. and Mrs. Hull worked in jobs which would not result in high compensation.[2] They had two children and, when each of these children was born, Mrs. Hull stayed off from work for approximately 2 years. The record shows that Billy Hull did not begin to work until about 1959 or 1960 and then worked primarily as a lab technician doing some extra work in connection with a recreational facility or gymnasium. Mrs. Hull, when she was working, was doing clerical work in a small community, Rossville, Georgia. It is inherently incredible that Mr. Hull could have saved $35,000 from any earnings he had plus any relatively small amounts that his grandmother might have given him in cash. Also, it is incredible that if Mr. Hull was saving money in this manner, he would not have put the money in a bank account to draw interest. He did have bank accounts and the record shows he did have some interest-bearing bank accounts. He claimed he put the money in a safe deposit box but did not support this claim by any evidence of renting a safe deposit box or records showing any entry he made to a safe deposit box. There is no evidence in the record to support the testimony of Mr. Hull

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2 Petitioners, who have the burden of proof, offered no evidence of the actual amount of their wages or salaries or of their expenses prior to the end of 1967 in support of Mr. Hull's claim that at the end of 1967 he had funds he saved from his compensation.

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that he had a safe deposit box or had any accumulation of cash.

The evidence in the record shows that Mr. Hull had a lifestyle that would belie a claim of saving money on a relatively small salary. Mr. Holcomb, in his testimony, referred to the number of automobiles Billy Hull had and his interest in auto racing. Although there is testimony that Katie Holcomb gave Billy Hull the automobiles, he must have expended money to keep up these automobiles. On the basis of this record, we therefore conclude that there is no credible evidence in the record to show that petitioners had cash of $35,000 at December 31, 1967.

The testimony given by Mr. Hull with respect to the $40,000 to $50,000 he dug up in his grandmother's yard is totally incredible. His explanation of how he obtained this money is the following:

> A * * * they rushed her to the hospital, then they called everybody in pretty quick and she was there, I'd say she was there one day and then the next day, that's when it happened, you know.
>
> * * *
>
> A We was all upset and my grandma, she died. I really don't know what--the vein busted in her head somehow or another. That's the reason she died. But she had--the doctors said she was having hardening of the arteries, and she was--one day she would be--she'd know exactly what's happening, she was real smart, and then the next day, she'd forget where she left things, and I think that was a problem.
>
> But they called us all in out there and they was in there working with her and we was out in the hall, and she called for me to come in, and I thought something was getting ready to happen, so I

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burst in there. They had tubes down her throat and oxygen, you know, in her arms and everything, and like to have scared me to death.

And, so, she kept muttering for me to come there, and I went over there, and she said come down here close so you can hear me. So, I got down real close to her, and she kept saying I'm going to tell you where I've got everything I've got. I said no, Kate, you just don't worry about that right now, said you just worry about getting well, and she said no, I've got to tell you this. She whispered to me in my ear and told me, and then—

* * *

A She told me, she said everything she had was buried. She told me where it was buried, and she said it's buried by the side of the house, in a little offset by the house that goes by the fence, and as you go in the house to unthaw the pipes in the winter time, there's a little thing right there and she said it's buried just as you go under, she said there's two containers buried. She says they are buried about three feet under the ground, and she says you get those, and then, of course, I was upset. I was really upset she was telling me that, and I wanted to think about her, see.

* * *

A Then the doctor made me go back out and then about, I guess, 10 to 15 minutes or 20 minutes, she died.

Q Did you check out what she had said?

A Yes, I did. I didn't right off. I was upset about the thing. We went--I made arrangements for the people to bury my grandmother, and I really didn't think about it for awhile. I guess it was maybe three weeks or whatever, then I thought about it, then I went down and talked to Richard, and Richard was her adopted son, and she--you know, she didn't--Richard didn't have nothing. She didn't give Richard nothing.

So, the house was in my name and her name, and, so, I give the house to Richard. I told Richard he could just have the house, and that's what happened.

Q Did you look for the money?

A No, I didn't then. But, I come back later, and then I went in the house to talk to Richard, and then when I come back out, I went out there and I found it.

Q How much was it?

A Well, I don't know that. I don't even know how much it was. It was—

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Q Where was it and how was it?

A It was in two glass containers. The glass containers are still there, I guess, but they ain't got no money in them, but they are still there. And, the money was in little--in rubber bands and little packages, and both the glass containers was full.

Q How big was the containers?

A Oh, they was big like a gallon jug. Maybe a little bit bigger than a gallon jug, but they was full. Both of them was full.

* * *

Q Mr. Hull, how soon was it after grandmother died that you first went to the place that she told you the money could be found and located?

A Two or three weeks, I guess.

Q And, do you have idea how long it stayed in the ground until it was exhausted?

A I have no idea.

Q Was it a period of years, months?

A I don't know. It was years and years and years. * * *

Q Now, what was your reason for leaving the money in the ground?

A Well, you just don't take it out. It's in a good, safe place. So, why would I take it out?

Q Well, you had a safety deposit box, did you not?

A Yes, I did. I had money in a safe deposit box.

Q And, then, why didn't you take this money out of the ground and put it in the safe deposit box?

A Well, I sure would have to get a big safety deposit box.

Q Weren't you concerned that somebody would find the money in the ground?

A I was the only one that knew where it was at.

Q The doctors and nurses were there, were they not, when your grandmother told you about it?

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A They couldn't have heard what she told me. I barely could understand what she was talking about.

It is inherently unbelievable that a woman 10 or 15 minutes from death, apparently with a massive stroke, with doctors and nurses attending her could have given the lengthy explanation of where money was hidden that Mr. Hull testified Mrs. Holcomb gave to him. Furthermore, if Mrs. Holcomb had in fact been in physical condition in the last 10 or 15 minutes of her life to be able to talk with such lucidness to her grandson, certainly petitioners could have offered the testimony of the nurses and doctors or the hospital records to show that she was conscious and lucid immediately prior to her death. Furthermore, Mr. Hull made no explanation of why he considered Mrs. Holcomb's statement to him to mean for him to take the money and keep it as his own. When specifically questioned, he stated that she never said she was giving him the money or for him to take the money for himself but merely told him where the money was. Apparently, from the record Mrs. Holcomb left no will. Mr. Hull's testimony was that there was no probate of any type of her estate. If Mr. Hull had found any of his grandmother's money he should have declared it as her estate and had it distributed to her heirs under Tennessee law. We do not believe Mr. Hull's testimony with respect to finding

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monies which were buried by his grandmother.[3] From the testimony as to the physical condition of Katie Holcomb for sometime prior to her death, it is unlikely that she would have been able to bury two large glass containers of money or remember where she had buried them if she had.

Even Mr. Hull's testimony is not that the amount of money he found buried was all spent in 1969. Obviously, even if Mr. Hull found and took some of his grandmother's money in 1969, this money could in no way affect the 1968 net worth computation. Mr. Hull's testimony was that he took years and years to spend the money, so the record does not show what effect any such cash funds could have had on the 1969 net worth computations. Mr. Hull has twice been convicted of felonies. By his own testimony he assisted his grandmother in an illegal activity of bootlegging. We do not believe his testimony with respect to the money he found or dug up after his grandmother's death.

Since petitioners have totally failed to show error in respondent's determination for the years 1968 and 1969, we

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[3] If we had believed Mr. Hull's testimony, we would not have concluded therefrom that the money was a gift to him but rather would have concluded that he appropriated for himself property of his grandmother's estate which should have been distributed to her heirs under Tennessee law.

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sustain that determination. Respondent has conceded that there is no deficiency for the year 1970.

Accordingly,

Decisions will be entered for the respondent with respect to the years 1968 and 1969 and for the petitioners with respect to the year 1970.

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UNITED STATES TAX COURT

JAMES E. BAYLESS AND JUDIE S. BAYLESS, ET AL.,[1] Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 15619-84, 19143-84, 19155-84, 19930-84, 20410-84, 20686-84, 25408-84, 31460-84, 35241-84, 35647-84. Filed March 24, 1986.

Donald Wolfson and Thomas Paris, for the petitioners.

Steven M. Walk, for the respondent.

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1 Cases of the following petitioners are consolidated herewith: Normand M. Lague and Paulette P. Lague, docket No. 19143-84; Frederic M. Kudish and Lynn Kudish, docket No. 19155-84; Norman Oler and Jacqueline Oler, docket No. 19930-84; Francis B. Falligant, Jr. and Elizabeth Falligant, docket No. 20410-84; Roy B. Sharrock and Ruth B. Sharrock, docket No. 20686-84; J. Kent Tupper and Joy S. Tupper, docket No. 25408-84; George L. Chapman and Genelea Chapman, docket No. 31460-84; Robert J. Echerd and Betty J. Echerd, docket No. 35241-84; and David L. Banta and Sandra L. Banta, docket No. 35647-84.

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MEMORANDUM OPINION

WILLIAMS, Judge: These consolidated cases are before this Court on the parties' cross-motions for summary judgment pursuant to Rule 121.[2] There are no genuine issues of material fact and summary judgment is appropriate.

In these consolidated cases, the Commissioner determined the following deficiencies in petitioners' Federal income taxes:

Docket No.	Petitioner	Taxable Year	Deficiency
15619-84	Bayless	1980	$ 2,499.07
19143-84	Lague	1980	1,760.00
19155-84	Kudish	1980	2,124.00
19930-84	Oler	1980	3,256.00
20410-84	Falligant	1980	2,717.29
20686-84	Sharrock	1980	3,939.00
25408-84	Tupper	1980	2,603.47
31460-84	Chapman	1981	3,126.80
35241-84	Echerd	1980	3,470.76
35647-84	Banta	1980	3,689.26

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2 All Rule references are to the Tax Court Rules of Practice and Procedure.

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The sole issue for decision is whether petitioners are entitled to a residential energy credit for geothermal renewable energy source property installed in their homes in 1980 or 1981.

The facts of these cases have been fully stipulated pursuant to Rule 122 and are so found. At the time their petitions were filed, petitioners resided at the locations indicated below:

Docket No.	Petitioner	Residence
15619-84	Bayless	Chagrin Falls, Ohio
19143-84	Lague	Auburn, New Hampshire
19155-84	Kudish	Cheshire, Connecticut
19930-84	Oler	Wynnewood, Pennyslvania
20410-84	Falligant (Francis)	Denver, Colorado
	Falligant (Elizabeth)	Dayton, Ohio
20686-84	Sharrock	Rossville, Georgia
25408-84	Tupper	Lincoln, Nebraska
31460-84	Chapman	Canal Fulton, Ohio
35241-84	Echerd	Greensboro, North Carolina
35647-84	Banta	Attica, Indiana

Each petitioner purchased and installed a Thermal Energy Transfer Corporation (TETCO) "Geothermal Ground-Water Heat Extractor" or other similar equipment in his principal

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residence, located in the United States, during the taxable year at issue in each case. The cost of the equipment and its installation was reported by each petitioner as geothermal renewable energy source costs on his tax return.

Each petitioner was the original user of the equipment and installed the equipment for the principal purpose of heating and/or cooling his dwelling. The equipment was designed to extract heat from, or dispel heat to, well water. The equipment could reasonably be expected to remain in operation for at least five years.

The temperature of the well water used by the equipment varied between 10 and 21.1 degrees Celsius, depending on the geographic location of the well. The temperature for each well remained relatively constant throughout the year. In general, section 44C[3] allows an income tax credit of 40% of

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3 All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years here in issue.

Section 44C, provided:

SEC. 44C. RESIDENTIAL ENERGY CREDIT.

(a) General Rule.--In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of--

(1) the qualified energy conservation expenditures, plus

(2) the qualified renewable energy source expenditures.

(b) Qualified Expenditures.--For purposes of subsection (a)-- * * *

(footnote continued)

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the amount of renewable energy source expenditures made by an individual during the taxable year. The only issue in these cases is the validity of the temperature limitation of section 1.44C-2(h), Income Tax Regs. This section of respondent's regulations defines "geothermal deposit" for purposes of

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(footnote continued from previous page)

(2) Renewable Energy Source.--In the case of any dwelling unit, the qualified renewable energy source expenditures are 40 percent of so much of the renewable energy source expenditures made by the taxpayer during the taxable year with respect to such unit as does not exceed $10,000. * * *

(c) Definitions and Special Rules.--For purposes of this section--* * *

(5) Renewable Energy Source Property.--The term "renewable energy source property" means property--

(A) which, when installed in connection with a dwelling, transmits or uses--

(i) solar energy, energy derived from the geothermal deposits (as defined in section 613(e)(3)), or any other form of renewable energy which the Secretary specifies by regulations, for the purpose of heating or cooling such dwelling or providing hot water or electricity for use within such dwelling, or

(ii) wind energy for nonbusiness residential purposes,

(B) the original use of which begins with the taxpayer,

(C) which can reasonably be expected to remain in operation for at least 5 years, and

(D) which meets the performance and quality standards (if any) which--

(i) have been prescribed by the

(footnote continued)

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section 44C(c)(5)(A)(i) as a geothermal reservoir having a temperature exceeding 50 degrees Celsius as measured at the wellhead. Section 1.44C-2(h), Income Tax Regs. Petitioners' equipment would qualify for the section 44C credit but for this temperature limitation of the regulations.

The validity of this regulation was recently considered and upheld by this Court in Peach v. Commissioner, 84 T.C. 1312 (1985), on facts indistinguishable from those in the present cases.[4] The Court in Peach held that the requirement of a minimum temperature for geothermal deposits of 50 degrees Celsius was neither unreasonable nor arbitrary. 84 T.C. at 1317.

Petitioners concede that their cases are controlled by Peach but ask us to overrule that case because the Court in

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(footnote continued from previous page)

Secretary by regulations, and

(ii) are in effect at the time of the acquisition of the property.

(6) Regulations.--

(A) Criteria; Certification Procedures.-- The Secretary shall by regulations--

(i) establish the criteria which are to be used in (I) prescribing performance and quality standards under paragraphs (3), (4), and (5), or (II) specifying any item under paragraph (4)(A)(viii) or any form of renewable energy source property. * * *

[4] See also, Reddy v. Commissioner, T.C. Memo. 1984-395, affd. by Court Order No. 85-1074 (4th Cir. August 29, 1985).

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Peach did not have before it certain scientific evidence presented in these cases in an affidavit of Dr. John M. Sharp, Professor and Associate Chairman of the Department of Geological Sciences at the University of Texas. In Dr. Sharp's opinion, scientifically there is no natural lower temperature boundary for geothermal deposits. Further, Dr. Sharp states that the heat content of all groundwater below a given depth is derived almost entirely from the earth's internal energy and is, therefore, by definition stored geothermal energy. On this basis petitioners argue that the lower limit for geothermal deposits of 50 degrees Celsius imposed under respondent's regulations is contrary to sound scientific opinion and arbitrary.

We do not doubt the accuracy of Dr. Sharp's scientific observations, but they are theoretical. Respondent's regulations, by contrast, are designed not to implement the theoretically correct answer but to apply the statute to effect Congress' intent in a reasonable manner. The legislative history of the provision fails to support petitioners' conclusion that respondents' regulations are unreasonable and arbitrary. The temperature limitation appears to be designed to eliminate equipment that uses

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standard technologies from qualifying for the credit. S. Rept. No. 95-529, 40 (1977), 1978-3 C.B. (Vol. 2) at 232. Petitioners' equipment, which is a type of heat pump, is just such equipment.

We decline to overrule Peach, and therefore we hold that petitioners' equipment does not qualify for the residential energy credit provided by section 44C since the temperature of each geothermal deposit utilized by petitioners' equipment is less than 50 degrees Celsius.[5]

Petitioners argue in the alternative that their equipment qualifies under section 44C as solar energy property. Respondent's regulations, however, specifically exclude property which uses heated underground water as an energy source from the definition of solar energy property. Section 1.44C-2(f)(1), Income Tax Regs. As Dr. Sharp stated in his affidavit, "The only way in which groundwater heat content could be said to derive from solar energy is where there is such extremely rapid downwards flow of ground water that there the thermal gradient is zero." Petitioners' claim that their

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[5] See also Chiple v. Commissioner, T.C. Memo. 1986-114.

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equipment qualifies as solar energy property is without merit.

To reflect certain concessions,

Decision will be entered under Rule 155 in docket No. 35241-84 and docket No. 20410-84.

Decision will be entered for the respondent in all other dockets.

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T. C. Memo. 1986-114

UNITED STATES TAX COURT

MICHAEL ANTHONY AND CYNTHIA M. CHIPLE, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 37309-84. Filed March 24, 1986.

Michael A. and Cynthia M. Chiple, pro se.

Steven M. Walk, for the respondent.

MEMORANDUM OPINION

WILLIAMS, Judge: This case is before the Court on respondent's motion for summary judgment pursuant to Rule 121.[1] There are no genuine issues of material fact and summary judgment is appropriate.

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1 All Rule references are to the Tax Court Rules of Practice and Procedure.

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The Commissioner determined a deficiency in petitioners' Federal income taxes for the taxable year 1981 of $2,924.42. The sole issue which we must determine is whether equipment purchased and installed by petitioners qualifies for a residential energy income tax credit as geothermal renewable energy source property.

The facts of this case have been fully stipulated pursuant to Rule 122 and are so found. Petitioners resided in Wadsworth, Ohio at the time their petition was filed.

Petitioners installed a Thermal Energy Transfer Corporation (TETCO) "Geothermal Ground-Water Heat Extractor" in their principal residence, in the United States, in 1981. Petitioners' equipment used as its energy source underground water which had a relatively constant year round temperature of 11.1 degrees Celsius. Petitioners reported $7,311.06 as geothermal renewable energy source costs on their joint income tax return for which they claimed an income tax credit of $2,924.42 pursuant to section 44C.[2]

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2 All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year here in issue.

Section 44C provided:

SEC. 44C. RESIDENTIAL ENERGY CREDIT.

(a) General Rule.--In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of--

(1) the qualified energy conservation expenditures, plus

(footnote continued)

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The sole point of controversy in this case concerns the validity of the temperature limitation of section 1.44C-2(h), Income Tax Regs. This section of respondent's regulations defines "geothermal deposit," for purposes of section

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(footnote continued from previous page)

(2) the qualified renewable energy source expenditures.

(b) Qualified Expenditures.--For purposes of subsection (a)-- * * *

(2) Renewable Energy Source.--In the case of any dwelling unit, the qualified renewable energy source expenditures are 40 percent of so much of the renewable energy source expenditures made by the taxpayer during the taxable year with respect to such unit as does not exceed $10,000. * * *

(c) Definitions and Special Rules.--For purposes of this section--* * *

(5) Renewable Energy Source Property.--The term "renewable energy source property" means property--

(A) which, when installed in connection with a dwelling, transmits or uses--

(i) solar energy, energy derived from the geothermal deposits (as defined in section 613(e)(3)), or any other form of renewable energy which the Secretary specifies by regulations, for the purpose of heating or cooling such dwelling or providing hot water or electricity for use within such dwelling, or

(ii) wind energy for nonbusiness residential purposes,

(B) the original use of which begins with the taxpayer,

(C) which can reasonably be expected to remain in operation for at least 5 years, and

(footnote continued)

Petitioners' claim for a residential energy income tax credit based on their purchase and installation of the TETCO "Geothermal Ground-Water Heat Extractor" was thus properly disallowed by respondent.[4]

Petitioners claim in the alternative that their equipment qualifies as a "Geosolar System, employing solar pond collection system." The stipulation of facts, however, declares that petitioners' equipment uses underground water as its energy source. Section 1.44C-2(f), Income Tax Regs., defining solar energy property, specifically excludes heated underground water from the scope of its definition. On this basis we hold that petitioners' equipment does not qualify as solar energy property within the meaning of section 44C(c)(5).

To reflect the foregoing,

Decision will be entered for the respondent.

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[4] See also Bayless v. Commissioner, T.C. Memo. 1986-113.

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44C(c)(5)(A)(i), as a geothermal reservoir which has a temperature exceeding 50 degrees Celsius measured at the wellhead. Section 1.44C-2(h), Income Tax Regs. Petitioners contest the validity of this regulation, arguing that it is arbitrary and inconsistent with Congressional intent.

This Court recently considered and upheld the validity of this regulation in Peach v. Commissioner, 84 T.C. 1312 (1985), on facts indistinguishable from those of the present case.[3] We find that our holding in Peach squarely applies to this case, and on this basis we hold that petitioners' equipment fails to qualify as geothermal renewable energy source property within the meaning of section 44C(c)(5).

(footnote continued from previous page)

(D) which meets the performance and quality standards (if any) which--

(i) have been prescribed by the Secretary by regulations, and

(ii) are in effect at the time of the acquisition of the property.

(6) Regulations.--

(A) Criteria; Certification Procedures.--The Secretary shall by regulations--

(i) establish the criteria which are to be used in (I) prescribing performance and quality standards under paragraphs (3), (4), and (5), or (II) specifying any item under paragraph (4)(A)(viii) or any form of renewable energy source property. * * *

3 See also Reddy v. Commissioner, T.C. Memo. 1984-395, affd. by Court Order No. 85-1074 (4th Cir. August 29, 1985).

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Respondent determined deficiencies in and additions to the Federal income taxes of petitioners Clarence W. Steinbrecher and Jeanette D. Steinbrecher (referred to as Mr. and Mrs. Steinbrecher, or the Steinbrechers) for 1980 and 1981 as follows:

Docket No. 29432-83
Clarence W. Steinbrecher

Year	Deficiency	Additions To Tax Under Sections 6651(a)	6653(a)	6654
1980	$3,911.98	$ 978.00	$195.60	$267.59
1981	$5,341.78	$1,335.45	$267.09	$409.24

Docket No. 29433-83
Jeanette D. Steinbrecher

Year	Deficiency	Additions To Tax Under Sections 6651(a)	6653(a)	6654
1980	$1,938.00	$484.50	$ 96.90	$123.38
1981	$2,627.00	$656.75	$131.35	$201.27

Respondent further determined that pursuant to section 6901 petitioner Laura Hettler (petitioner) was liable as transferee of assets of the Steinbrechers for the 1980 and 1981 deficiencies and additions to tax as well as those for Mr. and Mrs. Steinbrecher for the taxable years 1975 to 1979 as set forth below:[3]

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3 The Federal income tax liabilities of Mr. Steinbrecher for 1975 to 1979 and those of Mrs. Steinbrecher for the years 1977 to 1979 have been previously adjudicated by this Court. Steinbrecher v. Commissioner, T.C. Memo. 1983-12, affd. 712 F.2d 195 (5th Cir. 1983). These liabilities are therefore not at issue here except to the extent that petitioner may be liable for them as a transferee under section 6901.

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Laura Hettler, Trustee, Transferee

Docket No. 29430-83
Jeanette D. Steinbrecher

Year	Deficiency	Additions To Tax Under Sections 6651(a)	6653(a)	6654
1977	$5,614.70	-0-	280.74	-0-
1978	5,556.13	1,389.03	277.81	177.40
1979	1,559.00	389.75	77.95	65.18
1980	1,938.00	484.50	96.90	123.38
1981	2,627.00	656.75	131.35	201.27

Docket No. 29431-83
Clarence W. Steinbrecher

1975	$1,924.03	$ 481.01	$ 96.20	$ 83.30
1976	2,382.58	593.76	119.13	88.47
1977	2,652.72	652.91	132.64	92.58
1978	6,857.44	1,714.36	342.87	218.92
1979	2,718.00	679.50	135.90	113.64
1980	3,911.98	978.00	195.60	267.59
1981	5,341.78	1,335.45	267.09	409.24

Respondent also determined that Mr. and Mrs. Steinbrecher were liable for additions to tax under section 6653(a)(2) for the taxable year 1981 on $5,341.78 and $2,627, respectively, which amounts were attributable to negligence. Respondent also determined that petitioner as transferee was liable for those section 6653(a)(2) additions.

At the time they filed their respective petitions, petitioners Laura Hettler, Clarence W. Steinbrecher and Jeanette D. Steinbrecher, resided in San Antonio, Texas.

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By letter dated July 3, 1984, respondent attempted to obtain information, books, and documents from petitioners. Respondent also attempted to have petitioners stipulate to those facts not in dispute. Petitioners failed to respond to respondent's letter and refused to stipulate to any facts as required by Rule 91(a).

On August 14, 1984, respondent served on each of the petitioners respondent's Request for Admissions. On that same date, respondent also served on each of the petitioners respondent's Request for Documents and respondent's Interrogatories to Petitioners. Petitioners were required to respond to the Request for Admissions and Documents by September 13, 1984 and to the Requests for Interrogatories by September 28, 1984.

Petitioners failed to respond or object to respondent's Request for Admissions as required by Rule 90.[4] Further, no

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[4] On October 2, 1984, respondent received several documents sent in response to his various requests.

Among the documents received was petitioner's response to respondent's Request for Admissions. We observe that in addition to being untimely, this document does not satisfactorily comply with the substantive requirements of Rules 90(c).

Petitioner also sent her response to respondent's request for documents and interrogatories as did Mr. and Mrs. Steinbrecher. These responses, however, do not comply with Rules 71 and 72, respectively. In fact, "Petitioner's Answer For Respondent's Interrogatories" contains tax-protester type arguments previously rejected by both this Court and the Fifth Circuit in Steinbrecher v. Commissioner, T.C. Memo. 1983-12, affd. 712 F.2d 195 (5th Cir. 1983), in opinions filed before the petitions of petitioner and the Steinbrechers were filed.

(footnote continued)

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During 1980 and 1981, Mr. Steinbrecher received commissions from various insurance firms and one other company totaling $24,370.08 and $29,191.18, respectively. Mr. Steinbrecher did not file a form 1040 for 1980 and 1981.[5] For the taxable years 1978-1981, Mrs. Steinbrecher did not file any forms 1040.

Since petitioners failed to respond to respondent's Request for Admissions, all of the facts supporting his determination with respect to the Steinbrechers' tax liabilities for 1980 and 1981 have been deemed admitted. Accordingly, we find that there are now due from Mr. and Mrs. Steinbrecher the deficiencies in and additions to income tax for 1980 and 1981 as determined in respondent's individual notices of deficiencies in docket numbers 29432-83 and 29433-83. Freedson v. Commissioner, supra; Morrison v. Commissioner, supra; Rule 90(c).

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5 This fact is deemed admitted by Order of this Court dated February 23, 1984, which deemed admitted subparagraphs (a) through (f) of paragraph 6 of respondent's answer in Docket No. 29432-83.

For the taxable years 1975-1980, Mr. Steinbrecher filed with the Internal Revenue Service Forms 1040 on which he reported no income, no income tax liability, and on which he stated objections based on the Fourth and Fifth Amendments to the United States Constitution. The returns for 1975-1979 were rejected by this Court and the Fifth Circuit as not being valid Federal income tax returns. The same statements of both Courts also apply to the return for 1980.

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petitioner is liable as a transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax.

Clarence W. Steinbrecher and Jeanette D. Steinbrecher are husband and wife and were married on August 21, 1976. Petitioner is related to them.

Since 1976, Mr. and Mrs. Steinbrecher have resided at 66 Wayside Drive, San Antonio, Texas (residence). In March, 1977, Mr. Steinbrecher transferred the residence by warranty deed to Mrs. Steinbrecher. In March, 1982, Mrs. Steinbrecher transferred the residence to petitioner as trustee for her son, Wade Steinbrecher. Petitioner gave no consideration to either Mr. or Mrs. Steinbrecher for the transfer of the residence.

On the date of the March 1982 transfer, the fair market value of the residence was in excess of the total deficiencies in and additions to income tax due from Mr. and Mrs. Steinbrecher. Their individual equities in the property on this date were not less than the total amount due from them. As a result of this transfer, Mr. and Mrs. Steinbrecher were each rendered and are insolvent and without assets with which to pay the deficiencies, additions to tax and interest due for the years 1975 to 1981.

We find that the transfer of property by the Steinbrechers to petitioner was made with the intent to hinder, delay, or defraud creditors, and the transfer has in fact hindered and

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delayed the Internal Revenue Service from collecting Federal income tax and interest due from them. Tex. Bus. & Com. Code Ann. sec. 24.02 (Vernon 1968).[6]

6
Sections 24.02 and 24.03 of Tex. Bus. & Com. Code Ann. (Vernon 1968) provide in pertinent part as follows:

24.02 Transfer to Defraud Is Void

(a) A transfer of real or personal property, a suit, a decree, judgment, or execution, or a bond or other writing is void with respect to a creditor, purchaser, or other interested person if the transfer, suit, decree, judgment, execution, or bond or other writing was intended to

(1) delay or hinder any creditor, purchaser, or other interested person from obtaining that to which he is, or may become, entitled; or

(2) defraud any creditor, purchaser, or other interested person of that to which he is, or may become, entitled.

* * *

24.03 Debtor's Transfer Not for Value Is Void

(a) A transfer by a debtor is void with respect to an existing creditor of the debtor if the transfer is not made for fair consideration, unless, in addition to the property transferred, the debtor has at the time of transfer enough property in this state subject to execution to pay all of his existing debts.

(b) Subsection (a) of this section does not void a transfer with respect to a subsequent creditor of or purchaser from the debtor.

See also In re MortgageAmerica Corp., 714 F.2d 1266 (5th Cir. 1983), which holds that under sections 24.02 and 24.03, a transfer in fraud of creditors is avoidable in that good title may pass to a transferee who does not have notice of the fraud and void in the very limited sense that creditors may otherwise treat the transferred property as though the transfer had never taken place. Thus, in the instant case it appears that the Federal government under Texas law could as a creditor attach or

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In his Request for Admissions, respondent in paragraph 34 omitted the number 1979 in the paragraph which stated that petitioner was liable as a transferee for the taxes of Mr. Steinbrecher for "1975, 1976, 1977, 1978, 1980, and 1981." This paragraph is inconsistent with paragraph 32 where respondent properly states that by notice of deficiency he determined that petitioner was liable as a transferee of Mr. Steinbrecher for the years 1975, 1976, 1977, 1978, 1979, 1980, and 1981. We need not rest our determinations for 1979 only on the likely fact that paragraph 34 contained an inadvertent omission overlooked by respondent and apparently by petitioners since there was no mention of this at any time. Under Texas law the entire transfer of property to petitioner not for value is void as to respondent. V.T.C.A. Bus. & C. section 24.03(a). Moreover, since we find that petitioner is a transferee under section 6901 for 1975, 1976, 1977, and 1978, it follows that she was a transferee for all subsequent years, including 1979.

Rule 121(b) provides that a decision shall be entered if the pleadings, answers to interrogatories, depositions, admissions, and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law.

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execute judgment upon the property in question as though the debtors had not transferred it. United States v. Chapman, 756 F.2d 1237 (5th Cir. 1985).

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All of the requirements for finding petitioner's tax liability as the transferee of property under section 6901 have been met by respondent with respect to all years in issue, and thus there is no genuine issue as to any material fact. Rule 121(b). We have found that there are income tax liabilities due from the Steinbrechers for 1980 and 1981. We also find that petitioner is liable as their transferee for all years in issue. Respondent's motions will be granted. Rule 121.

In answers filed in docket numbers 29432-83 and 29433-83, respondent affirmatively alleged that damages should be awarded to the United States pursuant to section 6673. By order dated February 23, 1984, we granted respondent's motion pursuant to Rule 37(c) and deemed admitted those portions of respondent's answer in docket number 29432-83 supporting the affirmative allegation for section 6673 damages.

At the hearing held on respondent's Motion for Summary Judgment, petitioners failed to produce any documents or provide the Court with any evidence that would effectively raise issues as to any material facts. Instead, Mr. Steinbrecher attempted to rehash those issues already settled in a previous litigation and reiterate the tax protester arguments he used there. Steinbrecher v. Commissioner, T.C. Memo. 1983-12, affd. 712 F.2d 195 (5th Cir. 1983).

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Congress has granted this Court the authority to award the United States up to $5,000 whenever it appears to this Court that proceedings before it have been initiated or maintained by the taxpayer primarily for delay or that the taxpayer's position in such proceedings is frivolous or groundless. Section 6673.

After a careful review of the record and in light of the manner in which the Steinbrechers have conducted this case, considering the outcome of their previous litigation, and our February 23, 1984 Order in docket number 29432-83, we find that the proceedings in docket numbers 29432-83 and 29433-83 were instituted and maintained primarily for delay and that the Steinbrechers' position in those proceedings is frivolous and groundless. Accordingly, we award to the United States damages of $5,000 in docket number 29432-83 and $3,500 in docket number 29433-83.

Decisions will be entered for the respondent in Docket Nos. 29430-83, 29431-83, 29432-83, and 29433-83.

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T. C. Memo. 1986-115

UNITED STATES TAX COURT

LAURA HETTLER, TRUSTEE, TRANSFEREE, ET AL.,[1] Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 29430-83, 29431-83, 29432-83, 29433-83. Filed March 24, 1986.

Clarence W. Steinbrecher, pro se.

David W. Johnson, for the respondent.

MEMORANDUM OPINION

PAJAK, Special Trial Judge: These consolidated cases were assigned pursuant to section 7456(d) and Rules 180 and 181 with respect to respondent's Motion for Summary Judgment filed pursuant to Rule 121.[2]

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1 Cases of the following petitioners are consolidated herewith: Clarence W. Steinbrecher, Transferor, Laura Hettler, Trustee, Transferee, docket No. 29431-83; Clarence W. Steinbrecher, docket No. 29432-83; and Jeanette D. Steinbrecher, docket No. 29433-83.

2 All section references are to the Internal Revenue Code of 1954 as in effect during the taxable years in issue, unless otherwise indicated. All rule references are to the Tax Court Rules of Practice and Procedure.

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motion was made by them under Rule 90 to withdraw or modify the admissions. Accordingly, pursuant to Rule 90(c) each of the requests contained in Respondent's Request for Admissions were deemed admitted on September 13, 1984. Freedson v. Commissioner, 65 T.C. 333 (1975), affd. on another issue 565 F.2d 954 (5th Cir. 1978); Morrison v. Commissioner, 81 T.C. 644 (1983).

On October 1, 1984, respondent filed Motions for Summary Judgment pursuant to Rule 121 on the basis that no material issue of fact remained by virtue of the deemed admissions. On November 5, 1984, the Court received petitioner's response to respondent's motion which was signed by Mr. Steinbrecher and filed in each docket.

At the hearing on respondent's motion in San Antonio, Texas, appearances were made initially by Mr. Steinbrecher and subsequently by each of the other petitioners, as well as by counsel for respondent. Mr. Steinbrecher was designated the spokesman for the petitioners. The issue for decision is whether respondent's Motions for Summary Judgment should be granted. We must first decide whether there are deficiencies in and additions to tax due from the Steinbrechers for the taxable years 1980 and 1981.

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Mr. and Mrs. Steinbrecher have never responded to respondent's Request for Admissions.

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As we find below, the Steinbrechers have been made insolvent by the transfer of real property to petitioner. We must therefore decide whether petitioner is a transferee of the Steinbrechers' within the meaning of section 6901 and liable for their income tax liabilities as set forth in respondent's notices of deficiencies in docket numbers 29430-83 and 29431-83, respectively.

Section 6901 provides for the assessment and collection of unpaid taxes from the transferee of the taxpayer who incurred the tax liability. This provision, however, does not create any separate liability; it merely provides a secondary method for enforcing the existing liability of the transferor. Segura v. Commissioner, 77 T.C. 734, 742 (1981); C.B.C. Super Markets Inc. v. Commissioner, 54 T.C. 882, 898 (1970). Whether a transferee is actually liable for the unpaid income tax liability of the transferor is determined under the laws of the state in which the property transfer occurred. Commissioner v. Stern, 357 U.S. 39, 45 (1958).

Section 6901(h) defines a transferee as follows:

> As used in this section, the term "transferee" includes donee, heir, legatee, devisee, and distributee * * *.

A transferee has been judicially defined as one who takes the property of another without full, fair and adequate consideration to the prejudice of the rights of creditors. First National Bank of Chicago v. Commissioner, 255 F.2d 759 (7th Cir. 1958). Under section 6902, respondent has the burden of proving that

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loss in the amount of $153 on their 1979 income tax return. They also purchased two show horses for eventual resale, Applewood Imp for $800 and Baby for $1,100. Applewood Imp was trained by Karen Meagher and was successfully shown by professional riders. The insured value of Applewood Imp based upon its show accomplishments and a veterinarian's examination was $35,000. During 1979 and 1980 petitioners also purchased five inexpensive school horses which were used for riding lessons.

Karen Meagher, who is licensed to give horse back riding lessons in the state of Massachusetts, has lived and worked on Race Lane Farm from the time petitioners purchased the property until the time of trial. During this time she was employed by her parents, petitioners, to manage the horse operation and as a condition of her employment she was required to reside at the farm. Petitioners provided Karen Meagher with room and board and paid her a salary of $75 per week from July of 1979 until October 10, 1980 and $100 per week from October 10, 1980 through the end of 1980.

Prior to petitioners' purchase of Race Lane Farm, Mrs. Meagher was not employed outside the home. She moved to Race Lane Farm during the summer of 1979 and lived and worked there until November 1981. Mrs. Meagher's duties at Race Lane Farm included acting as a ground coach for Karen while she was training a horse, outside maintenance, driving children to and from lessons, overseeing children at lessons or horse shows,

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mucking stalls, secretarial work at horse shows, and helping to handle horses. Her average workday during 1979 and 1980 extended from 9:00 in the morning until dark.

Richard Meagher resided in West Boylston, Massachusetts, during the years at issue. However, he traveled to Race Lane Farm every weekend and, when required, during the week. Mr. Meagher's duties included maintenance work, keeping the financial records and the overall financial management of the enterprise.

Petitioners' son Kevin did not reside at Race Lane Farm. However, he was generally there during horse shows and for holidays. During 1979 and 1980, petitioners employed at least four individuals other than Karen Meagher to work at Race Lane Farm. These employees were paid by check and the required federal and state taxes were withheld from their wages.

Petitioners did not socialize or entertain guests at Race Lane Farm and they did not join area social clubs or frequent the area beaches. Holidays were spent at Race Lane Farm because the other hired help did not work on holidays.

During 1979 and 1980, petitioners advertised their horse business in local newspapers, New England horse publications and a leading national horse business publication.

During the winter petitioners conducted a horse show at Race Lane Farm about every six weeks. During the summer shows were held less frequently. Prior to the purchase of Race Lane Farm in June of 1979, petitioners maintained no separate checking account

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for their horse operation. However, petitioners did prepare periodic summaries of horse expenses during the year and year-end summaries for preparation of petitioners' tax returns. After the purchase of Race Lane Farm, petitioners opened a separate bank account for their horse activity and maintained detailed monthly business records similar to those maintained by Mr. Meagher in his accounting practice.

On their Federal income tax returns for 1973 through 1980, petitioners reported losses from their horse activities in the following amounts:

Year	Loss Claimed
1973	$ 9,318
1974	20,060
1975	9,992
1976	7,162
1977	18,987
1978	21,604
1979	56,848
1980	95,837

In reporting income, expense, and credits in respect of their horse activity, petitioners claimed deductions for automobile expense, food expense, and depreciation. They also claimed investment tax credits. In his notice of deficiency, respondent substantially disallowed these deductions and credits on the ground that they were not allowable even if petitioners' horse operation was an activity engaged in for profit.

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variance from the town of Barnstable which would permit them to operate a business on the premises. In June, 1979, petitioners acquired title to the property which consisted of 13.5 acres of land including a two bedroom house, a barn, and an indoor riding arena. Petitioners were unable to begin active operation of Race Lane Farm until September of 1979 since the grounds were in poor condition, the arena and barn required improvements, and Mr. Meagher had suffered a heart attack in January 1979.

The house at Race Lane Farm was furnished with items brought from petitioners' home in West Boylston and several other furnishings and carpets purchased by petitioners.

Petitioners added several improvements to the barn and arena. They built six more stalls in the barn which originally contained ten box stalls on the first floor and six box stalls on the second floor. The arena, which was built in 1974, is a metal building used for riding, training and showing horses. During 1979, petitioners installed indoor arena lights for night lessons and horse shows. Most of the labor for these and other improvements was supplied by petitioners and their daughter Karen.

Once petitioners completed the building improvements and ground maintenance, they began operations which included providing riding lessons, training and boarding horses owned by petitioners and others, and running horse shows.

In 1979 petitioners sold Tammany for $6,300 and reported a

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Since petitioners have been unable to generate a profit from their horse activities and the claimed losses represent substantial out-of-pocket expenses, petitioners are attempting to sell Race Lane Farm and have listed it for sale with a real estate broker at a price of $695,000.

OPINION

I

Section 183(a) generally provides that if an individual's activity is not engaged in for profit, "no deduction attributable to such activity shall be allowed under this chapter except as provided in this section." Section 183(a). Section 183(c) defines an activity not engaged in for profit as "any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212."

The standard for determining whether the expenses of an activity are deductible under either section 162 or section 212(1) or (2) is whether the taxpayer engaged in the activity "with the actual and honest objective of making a profit." Dreicer v. Commissioner, 78 T.C. 642, 645 (1982), affd. in an unpublished opinion, 702 F.2d 1205 (D.C. Cir. 1983); Allen v. Commissioner, 72 T.C. 28 (1979).

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The taxpayer's expectation of profit need not be reasonable but he must establish that he entered into the activity or continued the activity with a bona fide intention and good faith objective of making a profit. Section 1.183-2(a), Income Tax Regs.; Allen v. Commissioner, supra, at 33. Whether petitioners had the requisite profit objective is a question of fact to be determined from all the facts and circumstances.

The regulations contain a list of relevant factors for consideration in determining whether an activity is engaged in for profit. These relevant factors are: (1) the manner in which the taxpayer carried on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on this activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or loss with respect to the activity; (7) the amount of occasional profit, if any, which is earned; (8) the financial status of the taxpayer; and (9) whether elements of personal pleasure or recreation are involved. Section 1.183-2(b), Income Tax Regs. No one factor is determinative, nor is the determination based upon whether the listed factors indicating a lack of profit exceeds the number indicating a profit objective or vice versa.

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Appley v. Commissioner, T.C. Memo. 1979-433. The determination is to be based on all the facts and circumstances. Engdahl v. Commissioner, 72 T.C. 659 (1979).

It is clear that raising, training and showing horses for sale may constitute a trade or business. Commissioner v. Widener, 33 F.2d 833 (3rd. Cir. 1929), affg. 8 B.T.A. 651 (1927). We believe that petitioners had a bona fide intention and good faith objective of earning a profit from their horse training and showing activities and their Race Lane Farm operations. Our conclusion is based upon the record as a whole and we have based many of our findings largely upon the uncontradicted testimony of petitioners and their daughter, Karen. We found them to be both candid and credible witnesses.

An analysis of the relevant factors as applied to petitioners' horse operations is as follows:

Factor (1): The Manner in Which the Taxpayer Carries on the Activity. Petitioners carried on their horse activities in a businesslike manner. During the period 1973 through May, 1979, petitioners used their personal checking account for their horse operations. However, Mr. Meagher prepared year-end summary ledgers and retained all invoices and bills relating to the horse activity. See Engdahl v. Commissioner, supra at 667.

When petitioners purchased Race Lane Farm, they established a bank account separate from their personal accounts, and maintained a ledger solely for their horse operation. They also

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maintained detailed employee payroll records and withheld income taxes and social security taxes from the wages paid to their employees.

Petitioners advertised their operation in horse publications, local newspapers and by exhibiting their horses at shows. See Bishop v. Commissioner, T.C. Memo. 1972-167; Pennington v. Commissioner, T.C. Memo. 1967-111.

In an effort to reduce expenses, petitioners moved their horses from the Saddle River Stables located in Sterling, Massachusetts, to less expensive facilities in Connecticut. Petitioners later purchased Race Lane Farm in order to expand their operation and develop a successful horse business. Prior to the purchase, petitioners seriously considered several other properties and prepared projected budgets and operating statements which indicated that the horse operations at Race Lane Farm would be profitable.

We conclude that petitioners carried on the horse activity in a businesslike manner and maintained accurate books and records.

Factor (2): Expertise of the Taxpayer or His Advisors. Petitioners' involvement with horses began in 1963 when their daughter, Karen, started riding lessons. During the period 1967 throughout 1973, petitioners considered purchasing a show horse for investment. They discussed the profit potential of buying a show horse, having it trained and later sold, with the owners and

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UNITED STATES TAX COURT

RICHARD P. MEAGHER AND JANE P. MEAGHER, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 35700-83. Filed March 24, 1986.

Charles B. Swartwood and Francis J. Russell, for the petitioners.

Ellen Pilsecker, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

DRENNEN, Judge: This case was assigned to Special Trial Judge Daniel J. Dinan pursuant to the provisions of section 7456(c) of the Internal Revenue Code[1] and Rules 180, 181 and 183, Tax Court Rules of Practice and Procedure.[2] The Court agrees with and adopts his opinion which is set forth below.

[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect for 1976-1980, unless otherwise indicated.

[2] All Rule references are to the Tax Court Rules of Practice and Procedure.

joint Federal income tax returns for the taxable years 1976, 1977, 1978, 1979 and 1980 with the Internal Revenue Service Center in Andover, Massachusetts.

Mr. Meagher has been a practicing accountant since 1949 and has been a certified public accountant since 1954. Net income from his practice for the years 1976 through 1980, inclusive, was:

Years	Incomes
1976	$56,911
1977	56,720
1978	90,969
1979	61,551
1980	112,458

Petitioners had no substantial income other than the income from Mr. Meagher's accounting practice. During the years 1950 to 1970, however, Mr. Meagher invested in four real estate ventures and realized a loss on only one of the investments.

Petitioners have two children--a son, Kevin, who was born on November 30, 1954, and a daughter, Karen, born on April 23, 1957.

Petitioners' first involvement with horses began in 1963 when their daughter, Karen, started riding lessons at a stable in Shrewsbury, Massachusetts. They originally leased horses for their daughter to ride. However, during the period 1965 through 1970, petitioners purchased various horses which were boarded and trained at stables in Shrewsbury and Southborough, Massachusetts and shown by their daughter at various horse shows. During the period 1967 throughout 1971, Mr. Meagher explored the

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possibilities of buying and selling show horses for profit with the owners and operators of the riding stables where their daughter's horse was boarded. Petitioners did not, however, purchase any horses for profit during this period.

In 1971 petitioners began boarding their daughter's horse at Saddle River Stables in Sterling, Massachusetts, which was owned and operated by Mr. and Mrs. Henry Hulick and managed by Mitchell and Kathryn Steege. The Hulicks had been in the horse business for more than 30 years. The Steeges, who also had been involved in the horse business a number of years, were accomplished instructors and professional riders of show horses.

During the period 1971 through 1972, petitioners discussed with the Hulicks and other people in the horse business the profit potential of investing in a show horse, having it professionally trained and thereafter sold.

On the advice of Mrs. Hulick, petitioners purchased their first investment horse, Tustin, in 1973 for $8,700. During the period 1973 through 1977, petitioners purchased two other investment horses, Easy Rider and Tammany, for $10,333. All of these horses were purchased on the advice of Mrs. Hulick, who received a commission on each sale.

These horses were boarded and trained at the Saddle River Stables and were shown at numerous horse shows by professional riders. Neither petitioners nor their daughter, Karen, rode the horses at shows. Petitioners, however, did attend some of the

horse shows where their horses were entered and at such shows sought the advice of other persons who appeared to be making money in the horse business.

Tustin was not a successful horse so petitioners sold it in 1976 for $7,400 and reported the gain on the sale, in the amount of $1,745, on their 1976 income tax return.

Petitioners were concerned with the large amount of expenses they were incurring at the Saddle River Stables. Therefore, in 1977 they moved their horse Tammany to Applewood Farm in Connecticut to be trained and shown by Clifford Gustafson. The cost of maintaining Tammany at Applewood Farm was substantially less than the cost incurred at Saddle River Stables.

In 1977 petitioners purchased a horse named Breakaway for $7,000 on the advice of Clifford Gustafson and Mitchell Steege. Breakaway was successfully shown at various horse shows by Clifford Gustafson, Mitchell Steege and Karen Meagher but due to an ailment had to be put down [killed] in 1981.

During 1977, on the advice of the Steeges, petitioners decided that if they were to be successful in the horse business they would have to own a facility where they could expand their operation.

In the latter part of 1977 petitioners and the Steeges agreed to enter into a joint venture for the purchase and operation of a horse training and lesson facility. Petitioners and the Steeges investigated numerous properties throughout

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Massachusetts, Connecticut, New York, New Hampshire and Rhode Island for such a facility. During 1977 and 1978, petitioners and the Steeges entered into serious negotiations for the purchase of farms in Simsbury, Connecticut, Easton, Massachusetts, and Norton, Massachusetts. In connection with their consideration of these properties Mr. Meagher and Mrs. Steege prepared income and cash-flow projections to determine the feasibility of the successful operation of each facility. While their projections indicated that these facilities would be profitable ventures, petitioners were unable to purchase any of these properties.

In the fall of 1978, petitioners and the Steeges investigated the possibility of purchasing a facility in West Barnstable, Massachusetts, now known as Race Lane Farm. Petitioners and the Steeges prepared income projections for Race Lane Farm for a two-year period which indicated that the facility could be operated at a profit. In December of 1978 petitioners entered into a purchase and sale agreement for the purchase of the West Barnstable property for $247,500. The Steeges did not participate in the purchase or operation of Race Lane Farm since they were satisfied with their own horse operation and they questioned whether the business could be operated correctly in the location.

As a condition of the sale, petitioners obtained a zoning

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OPINION OF THE SPECIAL TRIAL JUDGE

Respondent determined deficiencies in petitioners' Federal income tax as follows:

Year	Deficiency
1976	$ 3,643.00
1977	7,890.88
1978	11,494.00
1979	20,867.00
1980	43,317.00

The issues for decision are: (1) Whether petitioners' horse operations constituted "an activity not engaged in for profit" within the meaning of section 183; and (2) if petitioners' operations are found to have been an activity engaged in for profit, whether petitioners are entitled to business and depreciation expense deductions and investment tax credits in excess of the amounts allowed by respondent.

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulations of fact and stipulated exhibits are incorporated herein by this reference.

Petitioners Richard P. Meagher (Mr. Meagher) and Jane P. Meagher (Mrs. Meagher), resided in West Boylston, Massachusetts, at the time they filed their petition in this case. They filed

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Race Lane Farm. During the winter, shows were conducted about every six weeks, while during the summer they were held less frequently. Third, the house had only two bedrooms, and both Mrs. Meagher and their daughter Karen resided there. In addition, we have no reason to think that Mr. Meagher and his son Kevin did not use the house when visiting the farm. We therefore think the use of the house by horse-show customers was inconsequential, and we decline to even attempt to allocate the basis of the house and its furniture and fixtures between personal and business use. See Steen v. Commissioner, supra, at 305.

As the last order of business there remains for our consideration the allowability of certain investment tax credits. On brief, petitioners continue to argue for an investment tax credit in respect of only one remaining type of property, namely, the furniture and fixtures in the house on Race Lane Farm. However, we have already held that the furniture and fixtures were not used in petitioners' business and are therefore not subject to the allowance for depreciation. Accordingly, they do not qualify for the investment tax credit.[5] Section 48(a)(1).

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[5] Should we be mistaken in our assessment that petitioners have abandoned their claim to investment tax credits in respect of other assets, suffice it to say that neither the arena nor the lighting installed therein qualifies as "section 38 property." The former is not a "single purpose agricultural structure," see section 48 (a)(1)(D); section 1.48-10(b), Income Tax Regs.; McKenzie v. Commissioner, 85 T.C. 875 (1985); and the latter constitutes a structural component of a building, see section 48(a)(1)(B); section 1.48-1(e), Income Tax Regs. Finally,

(footnote continued)

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Given our disposition of the disputed issues,

Decision will be entered under Rule 155.

(footnote continued from previous page)
petitioners have failed to show that respondent erred in disallowing 50 percent of the investment tax credit claimed in respect of an automobile. Rule 142(a).

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operators of the stables where their daughter's horse was boarded. During 1973 to 1979 all horses purchased by petitioners were selected, trained and shown by professional trainers other than petitioners' daughter, Karen.

Petitioners continually educated themselves on how to train and show horses for a profit. They sought advice from their professional trainers and riders and attended horse shows in order to discuss with other investors the profit potential of purchasing, training and showing horses.

Petitioners hired their daughter, Karen, a licensed professional rider with more than 15 years experience with horses, to manage the day to day operation of Race Lane Farm while Mr. Meagher managed the business' financial matters.

We believe that the expertise of petitioners, which was developed through their involvement with show horses, their reliance on advisors and their continuous consultations with other trainers and investors, strongly indicates an actual and honest profit objective.

Factor (3): Time and Effort Expended by the Taxpayer in Carrying on the Activity. Prior to the purchase of Race Lane Farm, petitioners devoted only a small amount of time to their horse activities. However, since petitioners hired professional trainers and riders to develop and show their horses, it was not necessary for petitioners to become more involved in the day-to-

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Factor (8): Financial Status of the Taxpayer. While petitioners had substantial income from Mr. Meagher's accounting practice and the losses from their horse activities generated substantial "tax benefits," we believe petitioners held a genuine hope of realizing an economic profit from the activities. In Engdahl we stated: "As long as tax rates are less than 100 percent, there is no 'benefit' in losing money. * * * The essential question remains as to whether there was a genuine hope of economic profit." 72 T.C. at 670.

Petitioners had no other significant investments and substantially all of their income was generated by Mr. Meagher's accounting practice. Since petitioners' horse activities have cost them substantial amounts of money and have demanded extreme personal labor and sacrifice, we are convinced they entered into this activity with the objective of making a profit.

Factor (9): Elements of Personal Pleasure or Recreation. Respondent contends that petitioners received personal and recreational benefits from their horse activities and, therefore, that these activities were not engaged in for profit. However, the facts do not support respondent's position.

Petitioners do not ride horses. Their investment horses were trained and ridden by qualified professionals. Petitioners' daughter, Karen, rarely rode any of petitioners' investment horses. After purchasing Race Lane Farm, petitioners and their daughter, Karen, spent a significant amount of time performing

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manual labor in order to improve and maintain the facility. They did not entertain friends at Race Lane Farm and sacrificed their social life in West Boylston for their involvement in their horse activities.

After consideration of the record as a whole, we conclude that petitioners pursued their horse activities with an actual and honest profit objective.

II

Since we have determined that petitioners' horse activity was engaged in for profit, we must next decide whether petitioners are entitled to (1) certain deductions for local automobile expense, food expense, and depreciation, and (2) certain investment tax credits.

From our examination of the record as a whole, we are satisfied that petitioners incurred substantial automobile expense in 1977 and 1978 in traveling to various horse shows and to the stables where their investment horses were kept. We are also satisfied that petitioners incurred automobile expense in 1979 and 1980. However, we think the amount of such expense in the latter two years was substantially less, because by then petitioners' horse activity had become concentrated in West Barnstable and petitioners had much less occasion to incur deductible transportation expense. Accordingly, using our best judgment, we hold that petitioners are entitled to 80 percent of

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the automobile expense which they claimed on their 1977 and 1978 returns and 40 percent of the automobile expense which they claimed on their 1979 and 1980 returns.

On their 1979 and 1980 returns, petitioners deducted $5,100 and $10,700, respectively, for food. These amounts were allegedly expended on behalf of petitioners' daughter Karen as well as petitioners themselves.

Petitioners contend that most of the food expense was allocable to their daughter and that it is deductible because the food was compensatory in nature. They also contend that the part of the food expense which was allowable to Mr. Meagher is deductible as travel expense.[3] We disagree. In our view, the food expense is personal and therefore nondeductible under section 262.

The record before us does not provide any basis upon which to allocate the food expense among Mr. Meagher, Mrs. Meagher, and their daughter.[4] In any event, we are not persuaded that the food furnished to Karen by her parents, and to her mother with whom she lived, was intended to be compensatory. Rule 142(a). Finally, we do not think the food expense allocable to Mr.

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[3] On brief petitioners appear to concede that the part of the food expense which was allocable to Mrs. Meagher was personal and therefore nondeductible under section 262.

[4] We are also not satisfied that the amount of expense for each year, which strikes us as excessive, has been adequately substantiated.

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Meagher qualifies as travel expense. See Preseault v. Commissioner, T.C. Memo. 1975-146. Accordingly, respondent's determination on this issue must be sustained.

On their 1979 and 1980 returns, petitioners claimed depreciation on the two-bedroom house, as well as on the furniture and fixtures therein, on Race Lane Farm. They contend that the sole use of this property was for business purposes, and that it is therefore depreciable, because their daughter's job required her to live on the premises and because the house was used by customers on nights before horse shows. We do not agree.

The record is clear that Mrs. Meagher resided in the house on Race Lane Farm. Petitioners' daughter Karen also resided there. Although Mr. Meagher resided in West Boylston, he traveled to Race Lane Farm at least every weekend and presumably stayed with his family in the house. Petitioners' son Kevin was also at the farm during horse shows and for holidays. Given this use of the house, we simply cannot conclude that it was used in petitioners' horse activity for purposes of section 167. Steen v. Commissioner, 61 T.C. 298 (1973), affd. per curiam 508 F.2d 268 (5th Cir. 1975); Russell v. Commissioner, T.C. Memo. 1982-709; Meeker v. Commissioner, T.C. Memo. 1981-215.

The fact that the house may have been used by customers on nights before horse shows does not demand a different conclusion. First, the record does not clearly disclose the degree of such use. Second, horse shows were not that common an occurrence at

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day operations in order to demonstrate a bona fide intention to make a profit. Appley v. Commissioner, supra; Section 1.183-2(b)(3), Income Tax Regs.

When petitioners expanded their operations with the purchase of Race Lane Farm, they devoted a substantial amount of time and effort in operating their horse activities. Most of the labor for the initial improvements and maintenance of Race Lane Farm were supplied by petitioners and their daughter Karen.

Mrs. Meagner lived and worked at Race Lane Farm for approximately two years. Mrs. Meagher's activities, which included acting as a ground coach, performing outside maintenance, overseeing children at lessons or horse shows and performing various other duties, constituted a full-time job. Mr. Meagher worked at Race Lane Farm every weekend and, when required, during the week. His work included performing manual labor on improvements and maintenance at Race Lane Farm and maintaining financial records.

Petitioners' daughter, Karen, who only received a small salary, worked long hours six to seven days per week in an effort to make the operation more successful.

The significant amount of time and effort devoted by petitioners and their daughter to the horse activities is persuasive evidence of a profit objective. Section 1.183-2(b)(3), Income Tax Regs.

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Factor (4): Expectation that Assets Used in Activity May Appreciate in Value. Petitioners intended to make a profit by purchasing horses, having them trained, shown at horse shows and later sold. Generally, when a horse is successfully shown, the value of the horse increases. Petitioners incurred substantial expenses in connection with the training and showing of their horses with the expectation that the value of their horses would increase. Two of petitioners' horses substantially appreciated in value. However, one of the horses, Breakaway, developed an ailment and had to be put down in 1981. The other horse, Applewood Imp, which was purchased for $800 in 1979 was successfully shown and later insured by petitioners for $35,000.

These facts further support our conclusion herein that petitioners' horse activities were operated with the intent to make a profit. Section 1.183-2(b)(4), Income Tax Regs.

Factor (5): The Success of Taxpayer in Carrying on Other Similar or Dissimilar Activities. Petitioners have not engaged in any similar horse activities in the past. Mr. Meagher, however, has invested in four real estate ventures in the past and petitioners realized a profit on three of these investments. In addition, Mr. Meagher manages his successful accounting practice. Mr. Meagher's success in these other businesses further supports petitioners' argument that their horse activity was engaged in for profit. Ellis v. Commissioner, T.C. Memo. 1984-50.

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Factor (6): The Taxpayers' History of Income or Losses with Respect to the Activity. Petitioners sustained a loss in each and every year since they became involved in the horse business. Generally, this would be considered a factor indicating that the activity is not engaged in for profit. However, a series of losses incurred during the initial stage of an activity and losses sustained because of unforeseen or fortuitous circumstances beyond the taxpayers' control, do not necessarily indicate that the activity was not engaged in for profit. Engdahl v. Commissioner, supra at 669; section 1.183-2(b)(6), Income Tax Regs.

We believe the losses sustained by petitioners are understandable. While the realization of large profits from an investment in show horses is possible, such an investment must be considered speculative. Petitioners suffered a severe setback when their most successful and promising horse, Breakaway, had to be put down due to an unforeseen ailment. Petitioners' more substantial losses were realized in 1979 and 1980 after the purchase of Race Lane Farm. Since petitioners were unable to begin active operation of Race Lane Farm until September, 1979, the business was in the start-up phase of its operation during 1979 and 1980. Therefore, the fact that petitioners sustained a loss each year does not indicate that Race Lane Farm was not engaged in for profit.

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Factor (7): Amount of Occasional Profits, If Any, Which Are Earned. While petitioners realized a small gain on the sale of their horse Tustin, they never earned a profit from their horse activities during any of the years at issue.

Section 1.183-2(b)(7), Income Tax Regs., provides in relevant part as follows:

> an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or only occasional small profits are actually generated.

Petitioners' investments in show horses was very speculative. However, there was the potential, while unrealized, that one or more of petitioners' horses would develop into an extremely valuable horse. Petitioners' horse, Breakaway, might have developed into such a horse had it not acquired an unforeseen ailment which required it to be put down. In addition, Applewood Imp has appreciated into a much more valuable horse and is insured for more than $34,000 in excess of its purchase price. This appreciation was not reflected in petitioners' horse operation losses since the horse was not sold during the years at issue.

In consideration of these circumstances, we do not place as much weight on the lack of profits from petitioners' horse operations as we might under other circumstances.

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UNITED STATES TAX COURT

SAMUEL L. ALEXANDER, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 27995-85. Filed March 24, 1986.

Samuel L. Alexander, pro se.

Darrell Knudtson, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

PANUTHOS, Special Trial Judge: This case is before the Court on respondent's Motion to Dismiss for Lack of Jurisdiction, filed on October 15, 1985.

In his statutory notice of deficiency, issued on February 8, 1984, respondent determined a deficiency of $5,955.00 in petitioner's 1980 Federal income tax. At the time of filing his

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petition, petitioner resided in Beltsville, Maryland. The issue before the Court is whether respondent mailed the statutory notice of deficiency to petitioner's "last known address."

Petitioner resided at 14218 Chadwick Lane, Rockville, Maryland at the time he filed his 1980 Federal income tax return. He continued to reside at that address until June of 1984.

On his 1980 return, petitioner listed his address as his residential address.[1] Petitioner was in oral and written communication with the Internal Revenue Service (I.R.S.) since September of 1982, regarding his 1980 income tax return. Petitioner received, at his Chadwick Lane address, a letter from an I.R.S. examiner, indicating that his tax returns for 1979, 1980, and 1981 were being examined. In fact, petitioner admitted that he received at his residence at least five pieces of correspondence from the I.R.S. with regard to the audit of his 1980 tax return. Petitioner denied having received the statutory notice of deficiency, sent by respondent on February 8, 1984 to the Chadwick Lane address.

Respondent sent the statutory notice of deficiency by certified mail to petitioner's residence in Rockville. When a letter is sent by certified mail, an attempt is first made to have the letter delivered by a mail carrier. If there is no

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At the hearing, petitioner contended that he used his post office box, P. O. Box 23360, L'Enfant Plaza Station, Washington, D. C. 20026, as his address on the return. Since neither party produced the return or a copy thereof at the hearing held on this matter, the record was left open and respondent later submitted as an exhibit a copy of the 1980 income tax return which clearly shows Chadwick Lane as petitioner's address.

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A valid statutory notice of deficiency and timely filing of the petition are both jurisdictional requirements in this Court. Mollet v. Commissioner, 82 T.C. 618, 623 (1984), affd. without published opinion 757 F.2d 286 (11th Cir. 1985); Frieling v. Commissioner, 81 T.C. 42, 46 (1983). Petitioner neither mailed nor filed his petition in this case within 90 days of the date on which respondent mailed the statutory notice to petitioner. Accordingly, we must grant respondent's motion to dismiss for lack of jurisdiction unless we find that the statutory notice was invalid. See sections 6212; 6213(a); 7502; Rule 13(c).[3]

Section 6212(a) authorizes respondent, when he determines that there is a deficiency in a taxpayer's Federal income tax, to send a notice of deficiency to the taxpayer by certified or registered mail. Generally, the mailing of the notice to the taxpayer's last known address is sufficient whether or not the notice is received. Frieling v. Commissioner, supra.[4]

For purposes of section 6212(b)(1), a taxpayer's last known address is that address to which, in light of all the facts and circumstances, respondent reasonably believed that the taxpayer wished the notice of deficiency to be sent. Delman v. Commissioner, 384 F.2d 929, 932 (3rd Cir. 1967), cert. denied 390 U.S. 952 (1968); Looper v. Commissioner, 73 T.C. 690, 696 (1980); Lifter v. Commissioner, 59 T.C. 818, 821 (1973). The last known

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[3] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated and all rule references are to the Tax Court Rules of Practice and Procedure.

[4] See also Tyler v. Commissioner, T.C. Memo. 1985-510.

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response, the carrier leaves a Form 3849 indicating that a piece of certified mail is waiting at the post office, and the letter is brought back to the post office. If the letter is not picked up within 5 days of the first attempt at delivery, a second notice is sent to the addressee.

The postal records for the Twinbrook Post Office in Rockville, Maryland, which has responsibility for delivering mail to Chadwick Lane, indicated that the post office attempted to deliver a certified letter from the I.R.S. to petitioner in February of 1984.[2] The letter was returned as unclaimed to the I.R.S. on February 25, 1984.

Petitioner did not receive a copy of the deficiency notice until April of 1985. Petitioner received the notice as part of a packet of information sent by respondent apparently in response to petitioner's request for information under the Freedom of Information Act. Petitioner received the notice at his post office box. He filed his petition on July 17, 1985.

The statutory 90 day period for filing a petition with the Tax Court after issuance of the February 8, 1984 notice of deficiency expired on May 9, 1984. Petitioner's petition was filed 17 months after the statutory notice was issued.

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At the hearing, petitioner questioned the testimony of the employee from the Twinbrook Post Office because he had no personal knowledge of the attempts to deliver the certified letter. The postal employee testified, however, as to the normal practice and procedure in attempting to deliver certified mail. Nothing in the record suggests that normal practice and procedure were not followed. See Tyler v. Commissioner, T.C. Memo. 1985-510, n. 6 and cases cited therein.

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address will be the address shown on the tax return filed by a taxpayer unless respondent has learned or has been notified by a taxpayer of a change of address. Keeton v. Commissioner, 74 T.C. 377, 384 (1980); O'Brien v. Commissioner, 62 T.C. 543, 549 (1974).

There may be, however, more than one address at which respondent may have reasonably believed a taxpayer wished to and could have received a notice of deficiency.[5] This is just such a situation. Respondent and petitioner had been in communication using both the post office box and the Chadwick Lane address. Petitioner testified at the hearing on this motion that he advised the audit examiner in December of 1983 that he had trouble receiving mail at the Chadwick Lane address. Nevertheless, absent clear and concise notification from a taxpayer directing respondent to use a different address, respondent may mail the statutory notice to an address at which he believes the taxpayer will receive it.

Section 6212(b)(1) was enacted to provide the Commissioner with a "safe harbor" address to which he could send a statutory notice, and it will be effective even though the taxpayer did not actually receive such notice because he had moved, died, or become incompetent. Section 6212(b)(1) was not intended to be used as a sword by the taxpayer. Mulvania v. Commissioner, 81 T.C. 65, 68 (1983). Merely telling the examining agent that he had trouble with mail delivery did not discharge petitioner's

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5 See Grubart v. Commissioner, T.C. Memo. 1979-409, affd. without published opinion 633 F.2d 203 (2d Cir. 1980).

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obligation of clear and concise notification that all mail should be directed to his post office box rather than at his residence. Based on this record, we cannot find that petitioner gave such notification to respondent.

The evidence offered by respondent established that respondent complied with the requirements of sections 6212(a) and (b)(1). Considering all the facts and circumstances presented here, respondent was entitled to rely on the Chadwick Lane address as petitioner's last known address. Accordingly, the notice of deficiency was valid and the petition was untimely. Respondent's motion to dismiss for lack of jurisdiction will be granted.

An appropriate order will be entered.

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Table 2

Cost of Goods Sold Categories Listed on Petitioner's Tax Returns	TAXABLE YEARS 1971	1972	1973	1974	1975
Cost of gas appliances sold	$ 324,726.73	$ 430,192.87	$ 305,369.89	$ 270,202.03	$ 337,388.33
Natural gas purchases	5,003,407.88	5,211,836.75	4,715,705.27	5,815,768.54	7,051,966.04
Propane gas expenses	60,077.24	16,816.51	34,289.54	6,044.68	1,142.40
Other gas supply expenses	3,207.44	2,603.77	3,326.80	2,566.28	5,625.38
Other storage expenses	---	---	---	---	75,181.59
TOTAL	$5,391,419.29	$5,661,449.90	$5,058,691.50	$6,094,581.53	$7,471,303.74

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petitioner applied enough of the customer deposit to cover the unpaid balance and, pursuant to the PSC's August 4, 1971, order, was required to refund any remaining amount to the customer.

In a relatively small percentage of cases, a customer's deposit was not claimed. Under Georgia law, such unclaimed deposits escheat to the State of Georgia after 15 years.[12]

The receipts, refunds, and credits regarding petitioner's customer deposit account for taxable years 1971 through 1975, are shown in table 1:

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12 The parties do not explain, and the record does not show, when this 15-year period begins to run, nor does the record show whether any such escheats were properly accrued during any of the years in issue. If this matter affects the amount of any deficiency for any of these years, then the parties are to resolve this matter as part of the computation under Rule 155.

Unless indicated otherwise, all rule references are to the Tax Court Rules of Practice & Procedure.

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T. C. Memo. 1986-118

UNITED STATES TAX COURT

GAS LIGHT COMPANY OF COLUMBUS, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 12620-78. Filed March 24, 1986.

Petitioner, a State-regulated natural gas utility company, collected customer deposits from customers who did not have established credit records. An order by the Georgia Public Service Commission required petitioner to refund a customer deposit if the customer established a record of prompt payment for a period of 24 months. If service was terminated before a customer established such a record, then petitioner's practice was to first apply the customer deposit to any outstanding balance in the customer's account and then refund any remaining amount of the customer deposit to the customer.

Held: (1) The customer deposits are primarily for the purpose of prepayment for goods and services and, thus, are includable in petitioner's income as advance payments. City Gas Co. of Florida v. Commissioner, 689 F.2d 943 (CA11 1982), revg. 74 T.C. 386 (1980), applied in accordance with Golsen v. Commissioner, 54 T.C. 742, 756-758 (1970), affd. 445 F.2d 985 (CA10 1971).

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(2) The customer deposits are advance payments (sec. 1.451-5(a), Income Tax Regs.) with respect to agreements for the sale of inventoriable goods, and so the year of inclusion in income is determined under section 1.451-5(c), Income Tax Regs.

(3) Treatment of the customer deposits as advance payments constitutes a change in petitioner's method of accounting for that item. Respondent's section 481 adjustment is largely sustained.

Howell Hollis and Gary L. Coulter, for the petitioner.

Albert L. Sandlin, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

CHABOT, Judge: Respondent determined deficiencies in Federal corporate income tax against petitioner for its taxable years ending August 31 of 1971, 1972, 1973, and 1975,[1] in the amounts of $126,916.04, $12,397.05, $118,600.54, and $178,043.58, respectively.

After settlement of other issues, the issues for decision[2] are as follows:

(1) Whether customer deposits received by petitioner are includable in petitioner's income.

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1 Unless indicated otherwise, all references to taxable years are to petitioner's fiscal years ending August 31.

2 The amount of petitioner's allowable net operating loss carryback from taxable year 1974 to taxable year 1971 depends both on the issue for decision and on the settled issues.

(2) If so, then (a) in what years the payments are includable, and (b) whether there has been a change of accounting method which results in a section 481[3] adjustment.

FINDINGS OF FACT

Some of the facts have been stipulated; the stipulations and the stipulated exhibits are incorporated herein by this reference.

When the petition was filed in the instant case, petitioner's principal office and place of business was in Columbus, Georgia.

Petitioner is an intrastate public utility company regulated by the Public Service Commission of Georgia (hereinafter sometimes referred to as "the PSC"). Petitioner's primary business is, and during the years involved in the instant case was, the acquisition, distribution, and sale of natural gas to residential, commercial, and industrial customers in that part of the metropolitan Columbus, Georgia, area that is in Georgia.

Petitioner maintains its books and prepares its Federal corporate income tax returns using the accrual method of accounting. Petitioner also maintains its books of accounts[4] in accordance with the Uniform System of Accounts as prescribed by

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[3] Unless indicated otherwise, all section references are to sections of the Internal Revenue Code of 1954 as in effect for the years in issue.

[4] So stipulated. The parties have not enlightened us as to what differences there are between petitioner's books and petitioner's books of accounts.

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the National Association of Railroad and Utility Commissioners[5] (hereinafter sometimes referred to as "NARUC"). NARUC's Uniform System of Accounts follows the Federal Power Commission's[6] system of accounts with respect to liquid natural gas properties.

During the years in issue in the instant case, petitioner required customer deposits from any customer who did not have an established credit record with petitioner.[7] Petitioner would not furnish gas to a customer who was required to make a customer deposit if the customer could not make such a deposit or get someone to guarantee payment of the bill. Petitioner required these customer deposits in order to insure payment of the customer's final bill of account. During the years in issue in the instant case, petitioner had customer deposits from about two-fifths of its total residential customers.

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5 This organization is now known as the National Association of Regulatory Utility Commissioners.

6 This organizaion is now known as the Federal Energy Regulatory Commission.

7 A customer who wanted to establish a credit record with petitioner could give petitioner credit information which petitioner would then check. If a credit record was established, then the customer could obtain service without making a customer deposit.

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The amount of the customer deposit required by petitioner rose over the years. During the period from 1971 until 1975 or 1976, the required deposit generally was $25. This amount was designed to cover a 2-month bill. The generally required amount was increased to $35 at some point in 1975 or 1976.[8]

When a customer made a customer deposit with petitioner, the customer signed a document entitled "CUSTOMER'S DEPOSIT RECEIPT". This document contains the following agreement:

> As security for the performance of a certain contract for service supplied at the above address, or continuation of similar service at other addresses. Said amount to be returned at date of discontinuance, provided all bills are paid to that date and all terms of said contract have been duly complied with. Interest to be paid on this amount at the rate and in the manner prescribed by the Georgia Public Service Commission.
>
> This receipt is not transferable, and must be returned when refund of deposit is requested, and is void when the deposit is refunded or applied on account.
>
> This Receipt is Not Negotiable [9]

Account 235 of NARUC's Uniform System of Accounts provides that the customer deposits account maintained by utility companies "shall include all amounts deposited with the utility by customers as security for the payment of bills." This account is a current liability account. During the years in issue in the

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8 Petitioner has required customer deposits at least as far back as its taxable year 1953. Originally, the amount required was $5. By 1968, the amount had risen to $15. By 1970, the amount had risen to $20.

9 This phrase is printed in slightly larger and slightly bolder capital letters.

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instant case, customer deposits received by petitioner were not reflected in petitioner's books as income or included in taxable income, but were carried on its books as liabilities.

When petitioner received the customer deposits, it deposited them in its general bank account, thus commingling the customer deposits funds with petitioner's other funds. Until and unless it came time to refund the customer's customer deposit, petitioner's use of the customer deposit funds was unrestricted.

On December 16, 1937, the PSC first prescribed a standardized rate of interest which electric and gas utility companies had to pay to customers on their customer deposits. In early 1971, the PSC considered prescribing a higher rate of interest on all customer deposits held by electric and gas utility companies operating in Georgia. On March 24, 1971, the PSC held a hearing on this matter. Petitioner was one of the utility companies which appeared at the PSC's hearing in opposition to the proposed interest rate increase. Testimony introduced by petitioner at this hearing showed that some of the customer deposits and the accumulated interest thereon were applied to reduce the net charge-off of uncollectable final bills.

In an order dated May 26, 1971, regarding the increase in interest rate, the PSC stated that it had received numerous complaints and charges alleging that the utility companies used the customer deposits as a source of low-interest capital funds. In response to this, the PSC stated in its order the following:

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While intentional accumulation by a utility company of large sums in the customer deposit account, without regard to the original purpose for which this account is provided, would indeed constitute misuse of such funds, the use of those funds made available in the normal course of business is, and has been for many years, treated by regulatory agencies as consistent with the public interest and with prudent utility management. Additionally, a blanket customer deposit policy is not intended as a substitute for the responsibility of a utility's management to protect itself diligently against unnecessary loss or to relax its efforts to collect all funds due on dilinquent accounts. There is at present no evidence before this Commission of any such violations by the utility companies involved in this proceeding.

The PSC ordered that the then-current practices of utility companies relating to customer deposit accounts be changed as follows:

ORDERED: that the rate of interest to be paid on deposits for utility service by applicants or customers of all electric and gas utility companies operating within the State of Georgia shall be at an annual simple interest rate of five percent (5%). Upon receipt of a cash deposit, the utility company shall furnish to the applicant for service or customer a receipt showing: (1) the date of deposit; (2) the name of the applicant or customer and the address of the premise to be served; (3) the type of service to be furnished; (4) the amount of the deposit and the rate of interest to be paid thereon. Customers shall be entitled, upon application to the utility company, to receive payment for the interest accrued on their deposits at any time but not more frequently than once each year.

ORDERED FURTHER: that upon discontinuance of service, the utility shall promptly and automatically refund the customers' deposits plus accrued interest or the balance, if any, in excess of the unpaid bills for service furnished by the utility.

ORDERED FURTHER: that any customer who has received utility service at the same location for twenty-four (24) consecutive months without having had service discontinued for non-payment of a bill and who has paid his monthly utility bills promptly and regularly, and if that customer is not at the end of such 24-month period delinquent in the payment of his

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bills, the utility company shall, within thirty (30) days of the end of the 24-month period, automatically refund the deposit plus accrued interest. If a customer has had service discontinued for non-payment of his bill within a consecutive twenty-four-month period, the utility shall thereafter review the account every twelve billings and, at the completion of a total period of twenty-four (24) months during which there has been no discontinuance of service for non-payment and during which a record of prompt and regular payment has been established, the utility shall automatically refund the deposit plus accrued interest, provided that the customer is not then delinquent in the payment of his utility bills. At the option of the utility, a deposit plus accrued interest may be refunded, in whole or in part, at any time earlier than the times hereinabove prescribed.

ORDERED FURTHER: that the provisions contained in this order shall become effective on and after July 1, 1971. Georgia Power Company, Savannah Electric and Power Company, Atlanta Gas Light Company, Gas Light Company of Columbus [petitioner], and United Cities Gas Company shall file revised tariffs with this Commission not later than June 30, 1971, reflecting appropriate changes in their customer deposit policies to conform with this order.

Petitions for rehearing, reconsideration, and oral argument were filed by two utility companies. The PSC granted the petitions and a rehearing was held on July 19, 1971. The following points were raised by the utility companies at the rehearing:

1. There were various mechanical and procedural problems related to implementing the May 26, 1971, order by that order's effective date--July 1, 1971.

2. Automatic refunds should be allowed to be made to customers on the anniversary date of their deposits during 1972.

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3. Interest should be paid on deposits only when held for six months or more.

4. The refund provision should apply only to residential customers and not to industrial and commercial customers.

On reconsideration, the PSC issued another order (dated August 4, 1971) replacing the May 26, 1971, order. The August 4, 1971, order provides in pertinent part as follows:

> ORDERED: That the rate of interest to be paid on deposits for utility service held six months or longer by applicants or customers of all electric and gas utility companies operating within the State of Georgia shall be at a simple interest rate of 5% per annum effective July 1, 1971.
>
> ORDERED FURTHER: That upon discontinuance of service, each utility shall promptly and automatically refund the customers' deposits, plus accrued interest on the balance, if any, in excess of the unpaid bills for service furnished by the utility.
>
> ORDERED FURTHER: That any residential customer who received utility service at the same location for 24 consecutive months without having had service discontinued for nonpayment of a bill, and who has paid his monthly utility bills promptly and regularly, and if that customer is not, at the end of such 24-month period, delinquent in the payment of his bills, the utility company shall within 30 days of the end of the 24-month period automatically refund the deposit plus accrued interest. Provided, however, that the term "promptly and regularly" shall not be construed to disallow the refund to a customer who has had only two delinquent bills during the 24-months period. If a customer has had service discontinued for nonpayment of his bill, or has not paid his bills promptly and regularly, the utility shall withhold the refund but thereafter review the customer's account every 12 billings, and at the completion of 24 months during which there has been no discontinuance of service for nonpayment and during which a record of prompt and regular payments has been established, the utility shall automatically refund the deposit plus accrued interest, provided the customer is not then delinquent

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> in the payment of his utility bills. At the option of the utility, a deposit plus accrued interest may be refunded in whole or in part, at any time earlier than the time hereinabove prescribed, and based on any credit review period less than 24 months in the discretion of the utility.
>
> ORDERED FURTHER: This automatic refund policy shall be placed in effect by each utility no later than January 1, 1972, and refunds to entitled residential customers shall be accomplished during the anniversary month of the customers' deposits during 1972.
>
> ORDERED FURTHER: Each utility shall file within 60 days for Commission approval, proposed revisions to its Rules and Regulations for methods and procedures implementing the substantive provisions of this Order.

Petitioner fully refunded a customer's deposit, plus any accrued interest, in only two situations. The first situation was when the customer established a record of 24 months of prompt payments. The full refund in this situation was required under the PSC's August 4, 1971, order. In this first situation, a full refund was made even though service continued. The second situation was when the customer terminated service, while the customer deposit was being held,[10] and the customer had fully paid the final bill.

Petitioner partially refunded a customer's deposit, plus any accrued interest, when the service was terminated[11] and there was an outstanding bill for services. In such a situation,

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[10] A customer's deposit was held as long as the customer had not established a record of 24 months of prompt payment.

[11] Service might be terminated either voluntarily by the customer (e.g., when the customer moved) or involuntarily by petitioner (e.g., when there was a bad payment record and collection efforts were unsuccessful).

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Table 1

Taxable Year	Customer Deposits Beginning Balance	Customer Deposits Receipts	Customer Deposits Refunds and Credits	Customer Deposits Ending Balance	Customer Deposits Balance Increase or (Decrease)
1971	$229,905	$235,505	$(218,640)	$246,770	$16,865
1972	246,770	192,720	(207,070)	232,420	(14,350)
1973	232,420	181,395	(172,305)	241,710[13]	9,290
1974	241,710	167,805	(168,265)	241,250	(460)
1975	241,250	172,370	(164,740)	248,880	7,630

On its income tax returns for taxable years 1971 through 1975, petitioner reported its cost of goods sold as shown in table 2:

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13 So stipulated. Since the taxable year 1973 beginning balance ($232,420) plus the receipts ($181,395) less the refunds and credits ($172,305) equal $241,510--$200 less than the stipulated ending balance--it is evident that there is an error. The record in the instant case does not enable us to determine whether the error lies in the receipts amount, the refunds and credits amount, or the ending balance amount. (If the error is in the ending balance amount, then the balance increase for the year would be $9,090.) This discrepancy does not affect our analysis, infra. The parties are directed to resolve this matter as part of the computation under Rule 155.

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* * * * * * *

The primary purpose of the customer deposits is prepayment for goods and services.

OPINION

We must decide whether petitioner's customer deposits are includable in petitioner's taxable income. If we conclude they are, then we must also decide in what taxable year they are to be included and whether a change in method of accounting has occurred and has triggered an adjustment under section 481.

Respondent contends that petitioner's customer deposits are includable in petitioner's income because their primary purpose was to act as a prepayment for goods and services. Respondent further contends that the taxable year of inclusion is controlled by section 1.451-5, Income Tax Regs. More specifically, respondent contends that the customer deposits are advance payments (as defined in section 1.451-5(a), Income Tax Regs.) relating to inventoriable goods and thus, "income must be recognized not later than the last day of the second year following the receipt of the advance payment" pursuant to section 1.451-5(c), Income Tax Regs. Finally, respondent contends that, if we conclude that petitioner's customer deposits are includable income rather than liabilities, as petitioner has accounted for them, then a change in method of accounting has occurred and an adjustment under section 481 is triggered.

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Petitioner contends that its customer deposits are not includable in income. Petitioner argues that three elements in the instant case are enough "to invalidate the characterization of the customer deposits as income." Firstly, the customer deposits were required of only about two-fifths of petitioner's customers. Secondly, the customer deposits were "required only for lack of credit rating, retained * * * only until creditworthiness had been established, and applied to the payment of gas bills in a minority of cases." Thirdly, the PSC ordered the customer deposits to be refunded after a customer had established a record of 24 months of prompt payments. As to the taxable year of inclusion, petitioner contends that the customer deposits do not meet the definition of "advance payment" under section 1.451-5(a), Income Tax Regs. Finally, petitioner argues that, if we conclude that the customer deposits are includable in income, then respondent incorrectly calculated the section 481 adjustment. Petitioner argues that "none of the customer deposits on the books prior to 9/1/70 can properly be considered" in making the calculation.

We agree in large part with respondent.

I. Includability in Income

The Court of Appeals for the Eleventh Circuit, to which an appeal in the instant case would lie, considered the issue of includability of customer deposits in income in a case factually

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similar to the instant case in City Gas Co. of Florida v. Commissioner, 689 F.2d 943 (CA11 1982), revg. 74 T.C. 386 (1980).

The Court of Appeals concluded that customer deposits to gas utility companies often serve mixed purposes--i.e., as prepayments for goods and services and also as security for the performance of nonincome-producing covenants or against property damage. City Gas Co. of Florida v. Comissioner, 689 F.2d at 946. The Court of Appeals held that if the primary purpose of the payment is the former (prepayment), then the payment is includable in gross income under section 61(a);[14] if the primary purpose of the payment is the latter (security), then the payment is not taxable. 689 F.2d at 946-948. Because this Court had not applied this primary purpose test (we had held that if the customer deposits were subject to refund, then they were not taxable (74 T.C. at 391)), the Court of Appeals remanded for further proceedings.

Both parties agree that the opinion of the Court of Appeals in City Gas Co. of Florida is controlling in the instant case. We agree. Golsen v. Commissioner, 54 T.C. 742, 756-758 (1970), affd. 445 F.2d 985 (CA10 1971). Consequently, whether the

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14 Section 61(a) provides, in relevant part, as follows:

SEC. 61. GROSS INCOME DEFINED.
(a) General Definition.--Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
* * *
(2) Gross income derived from business;

customer deposits in the instant case are includable in income depends on whether the primary purpose for the customer deposits is as prepayment for goods and services, or is as security for the performance of nonincome-producing covenants or against property damage.

The following facts which we have found, supra, lead us to conclude that the primary purpose of the customer deposits is as prepayment for goods and services.[15]

1. The parties stipulated (and we have found, supra) that petitioner required the customer deposits "to insure the payment of the [customer's] final bill".

2. The document which the customer signed when making a customer deposit contained an agreement which stated, in part, that the customer deposit was security for the performance of the contract of service between petitioner and the customer. The agreement further indicated that the customer deposit could be applied against the customer's account. The agreement does not mention whether the customer deposit could be applied toward property damage or any other nonincome-producing covenant.

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15 As to the significance of petitioner's commingling of the customer deposit funds with its other funds, and petitioner's unrestricted use of the customer deposit funds, see City Gas Co. of Florida v. Commissioner, 689 F.2d 943, 948 n. 7 (CA11 1982).

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3. Under NARUC's Uniform System of Accounts, the account for customer deposits is to include "all amounts deposited with the utility by customers as security for the payment of bills."

4. Petitioner testified before the PSC that, in fact, it did apply customer deposits to reduce the charge-off of uncollectible final bills.

5. As part of petitioner's policy of refunding customer deposits, in certain cases it applied the customer deposit toward an unpaid final bill, refunding any remainder.

Petitioner contends that three factors distinguish the instant case from City Gas Co. of Florida v. Commissioner, supra. Firstly, petitioner required customer deposits from only some of its customers--i.e., those without established creditworthiness--rather than from all of its customers. Secondly, the customer deposits were retained "only until creditworthiness had been established, and applied to the payment of gas bills in a minority of cases" rather than "customarily applied to the customers' final bills". Thirdly, petitioner was under order by the PSC to refund the deposits after 24 months of prompt payment (unless refunded earlier, in full or in part, when service was terminated).

As we understand the Court of Appeals' opinion, customer deposits must be categorized either as prepayment for goods and services, on the one hand, or as security for the performance of

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deposits received during a year are includable in petitioner's income for that year, unless, under petitioner's method of accounting, the customer deposits are "to be properly accounted for as of a different period."

Respondent contends that the customer deposits are advance payments (as defined in section 1.451-5(a), Income Tax Regs.), relating to inventoriable goods and, as such, are includable in income not later than the second year following the year of receipt of these customer deposits, under section 1.451-5(c), Income Tax Regs.

Petitioner maintains that the customer deposits do not meet the definition of advance payments under the regulation.[18] Petitioner does not, however, suggest when the customer deposits are includable in income if we conclude that they are not advance payments under section 1.451-5, Income Tax Regs. (Respondent states that, if we were to agree with petitioner that the regulation does not apply, then "it is respondent's position that case law and legislative history mandate the inclusion of the advance payments in income in the year of receipt.")

(footnote continued from previous page)
which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

[18] Petitioner does not challenge the validity of the regulation and we see no basis for doing so in the instant case. See, e.g., Bingler v. Johnson, 394 U.S. 741, 750 (1969).

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The definition of advance payments, under section 1.451-5(a), Income Tax Regs.,[19] consists of three parts. Firstly, the payment must be an amount received "pursuant to" an agreement for sale or other disposition in the future of goods. Secondly, the payment is "to be applied against" such agreement. Thirdly, the goods which are the subject of the agreement, must be "goods held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business".

We consider these requirements seriatim. Firstly, in substance the customer deposits were looked to as payment for any unpaid final bill for the sale and purchase of gas under the agreement between petitioner and the customers. As we found, supra, petitioner's representatives testified to this effect before the PSC and petitioner's refund policy reflected this. Thus, in substance the customer deposits were received "pursuant

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19 Section 1.451-5(a), Income Tax Regs., provides, in relevant part, as follows:

Section 1.451-5. Advance payments for goods and long term contracts.

(a) Advance payment defined. (1) For purposes of this section, the term "advance payment" means any amount which is received in a taxable year by a taxpayer using an accrual method of accounting for purchases and sales * * * pursuant to, and to be applied against, an agreement:

(i) For the sale or other disposition in a future taxable year of goods held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *

(2) For purposes of subparagraph (1) of this paragraph:

(i) The term "agreement" includes * * * (b) an agreement which obligates a taxpayer to perform activities described in subparagraph (1)(i) * * * of this paragraph and which also contains an obligation to perform services that are to be performed as an integral part of such activities; and

(ii) Amounts due and payable are considered "received".

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to" the basic agreement to sell and purchase gas. Petitioner states that the customer deposit "by its terms is merely security for the performance of the first agreement" (the "basic agreement for the sale and purchase of gas"). We have already held that the customer deposit served primarily as a prepayment for goods and services. These are the goods and services that petitioner is selling to its customers. Petitioner's insertion of the term "security" in the customer deposit agreement does not change the substance of the customer deposit's role in petitioner's agreement to furnish goods and services. See City Gas Co. of Florida v. Commissioner, 689 F.2d at 948 n. 7. Petitioner also contends that the "pursuant to" requirement of the regulation is not met because the customer deposit is not required of all its customers. We see nothing in the regulation suggesting that a payment is not an advance payment unless it is required of all customers. We conclude that this first part of the regulation's definition of advance payment is satisfied.

Secondly, under both the PSC August 4, 1971, order and petitioner's refund policy, customer deposits could be applied to unpaid bills for the sale and purchase of gas. It was more than just "a mutually covenient way of closing out the account", as petitioner contends. In fact, as we have found, supra, petitioner's representative testified before the PSC that the customer deposits were looked to for reducing the charge-off of uncollectible final bills. Petitioner's freedom to apply the customer deposits to unpaid bills, petitioner's policy to so

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apply the customer deposits, and petitioner's actual application of the customer deposits lead us to conclude that the second part of the regulation's definition of advance payments is satisfied.

Thirdly, the parties have stipulated (and we have found) that petitioner's primary business was "the acquisition, distribution, and sale of natural gas to * * * customers". On its income tax returns for each of the years in issue, petitioner reported costs of goods sold and each year substantially all (upwards of 92 percent) was described by petitioner as "Natural gas purchases". (See table 2, supra.)

Petitioner contends that "goods" means only "goods on the taxpayer's shelves or in his warehouse or to be manufactured by the taxpayer or by someone else and sold through the taxpayer to the customer in the future, as in Example 2 under Reg. §1.451-5(b)(2). It is generally recognized that Reg. §1.451-5 sprang from Hagen Advertising Displays, Inc. v. Commissioner 407 F.2d 1105 (6th Cir. 1969) and similar cases dealing with hard goods. * * * Moreover, petitioner never has the gas in its inventory: The gas is received from petitioner's pipeline supplier and simultaneously delivered to its customers, remaining in petitioner's mains only for the brief time it takes to pass from the pipeline to the consumer's house or place of business."

Firstly, the language of the regulation is not so limited. Secondly, although Hagen Advertising Displays, Inc. v. Commissioner, 407 F.2d 1105 (CA6 1969), affg. 47 T.C. 139

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(1966), involved manufactured goods, nothing in either the Court of Appeals' opinion or our opinion in that case suggests that a definition of advance payments should be limited to the definition of goods for which petitioner contends. Thirdly, the example which petitioner relies on is inapposite to the point it is trying to make. Section 1.451-5(b), Income Tax Regs., deals with the taxable year of inclusion of advance payments. Example 2 describes when a manufacturer of certain goods must include advance payments in income under a specific set of circumstances. It is not an example of, and does not limit, the definition of advance payments. Finally, insofar as petitioner is suggesting that "goods" means goods which are usually the type thought to constitute inventory, we note that natural gas which is transmitted through pipelines is considered to become inventory when it enters the pipeline, and not merely when it enters the pipeline company's storage facility. See Northern Natural Gas Co. v. Commissioner, 44 T.C. 74, 77-79 (1965), affd. 362 F.2d 781 (CA8 1966). Also, we note that petitioner's senior vice president testified that, in 1973, petitioner's gas mains had from 2,251 MCF to 1,861 MCF (i.e., from 2,251,000 cubic feet to 1,861,000 cubic feet) of gas, depending on the pressure that the gas was subjected to. In addition, the parties stipulated that, during its taxable year 1974, petitioner constructed and placed in service a new liquid natural gas facility which was used to liquify and store excess supplies of natural gas during

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periods of low consumption, and vaporize the gas during periods of high consumption. Petitioner spent about $4.7 million on this facility.

We conclude that the third part of the definition is satisfied and, thus, the customer deposits in the instant case constitute advance payments for purposes of section 1.451-5, Income Tax Regs.

Respondent, in the notice of deficiency, determined that the customer deposits were advance payments for inventoriable goods and so qualified for the limited deferral from inclusion in income provided under section 1.451-5(c), Income Tax Regs. Under this rule, the customer deposits must be included in income no later than the last day of the second taxable year following the year in which substantial advance payments are received. Respondent determined that under this rule, income from customer deposits was includable as income in fiscal years 1973 and thereafter.

Petitioner contends that if we conclude that respondent is correct as to the taxable year of inclusion, then because of petitioner's refund policy "we would be presented with the anomolous [sic] situation that * * * petitioner would be required to report as income money which it had already refunded to its customers." (Emphasis in original.)The problem to which petitioner adverts does not appear to be present in the instant case, since in the notice of deficiency respondent used net figures in calculating the amounts of customer deposits

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includable in income under section 1.451-5(c), Income Tax Regs. That is, respondent has already accounted for the refunds of customer deposits.[20]

We hold for respondent on this issue.

III. Change in Method of Accounting; Section 481 Adjustment

Respondent contends that his "change in petitioner's treatment of customer deposits constitutes a change in petitioner's method of accounting, requiring adjustments pursuant to I.R.C. §481." Respondent, in the notice of deficiency, determined that the change in methods of accounting occurred in taxable year 1973[21] and made an adjustment under section 481, for the period beginning September 1, 1953, and ending August 31, 1972.

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20 The amounts used by respondent were the ending balances of the customer deposits accounts. (See table 1, supra.) The ending balance figure is calculated by taking the opening balance of the customer deposits, adding to it the amounts of customer deposits received during the fiscal year, and subtracting from it the amounts of customer deposits refunded or credited to customers.

21 Respondent determined that the first year for which petitioner did not correctly report the customer deposits as advance payments (and for which the statute of limitations period evidently has not run) was taxable year 1971. Under section 1.451-5(c), Income Tax Regs., however, the first year that petitioner's taxable income was changed was taxable year 1973, because of the 2-year deferral rule. The year of the change in the taxpayer's method of accounting is defined as "the taxable year for which the taxable income of the taxpayer is computed under a method of accounting different from that used for the preceding year." Section 1.481-1(a)(1), Income Tax Reg. (emphasis added). Accordingly, in the instant case the year of change is taxable year 1973 (not 1971)--which is what respondent determined.

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nonincome-producing convenants or against property damage, on the other hand. The Court of Appeals' test does not allow for other categories.[16] Thus, it is not enough for petitioner to show that the distinctions in the instant case mean that there is less than a good fit for the customer deposits in the prepayment category. Petitioner must also show that as a result of the distinctions, there is a better fit in the security category.

To begin with, based on the record in the instant case, we are unable to find that the primary purpose of the customer deposits is as security against property damage or for performance of nonincome-producing covenants. We note, for example, an absence of any mention of this possible purpose in the agreement contained in the document a customer signed upon making a deposit, as well as in the PSC order.

Further, we do not see how the three distinctions petitioner points to show that the purpose of the customer deposits fit better in the nonincome-producing category rather than the income category. In fact, as to the third distinction raised by petitioner--i.e., that the customer deposits were subject to refund under order by the PSC--the Court of Appeals concluded that the possibility of a refund under certain

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16 See City Gas Company of Florida v. Commissioner, T.C. Memo. 1984-44 (47 T.C.M. 971, 973, 53 P-H T.C. Memo par. 84,044).

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circumstances was not enough to exclude the customer deposits from income. City Gas Co. of Florida v. Commissioner, 689 F.2d at 946. These distinctions do not make a difference.

Petitioner contends that it treats the customer deposits as liabilities on its books, pursuant to the NARUC Uniform System of Accounts, and that this is inconsistent with taxing the customer deposits as income. The Court of Appeals of the Eleventh Circuit specifically rejected this argument in City Gas Co. of Florida v. Commissioner, 689 F.2d at 949, and we are bound by this rejection.

Petitioner contends that the customer deposits, even if they are advance payments, are not income so long as petitioner's right to retain them is contingent. The Court of Appeals for the Eleventh Circuit specifically rejected this argument in City Gas Co. of Florida v. Commissioner, 689 F.2d at 949-950, and we are bound by this rejection.

We conclude that the primary purpose of the customer deposits was securing prepayment for goods and services; thus, the customer deposits are includable in petitioner's income.

We hold for respondent on this issue.

II. Year of Inclusion

We have held that the customer deposits are includable in petitioner's gross income. Under section 451(a),[17] the customer

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SEC. 451. GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.

(a) General Rule.--The amount of any item of gross income shall be included in the gross income for the taxable year in

(footnote continued)

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period from the beginning year through taxable year 1973, and adding up all the amounts of the customer deposits refunded or credited during the same period, and then subtracting the total customer deposits refunded or credited from the total customer deposits received. Thus, respondent's method of calculating the section 481 adjustments takes into account any refunds, required to be made by the PSC because a customer had a record of prompt payment for 24 months, which were actually made.

Petitioner's detailed approach would have the effect of allowing petitioner to deduct the September 1, 1970, customer deposit balance of $229,905 even though petitioner had never taken these customer deposits into account on either an individual or net basis. If petitioner's general approach were correct, then the entire August 31, 1972, customer deposit balance of $232,420 should be taken into account in petitioner's taxable year 1973, since all of this amount was still on hand at the beginning of this taxable year and none of this amount had previously been taken into income.

Section 481 is designed to reduce the dislocative effect of correcting accounting method errors, without permitting taxpayers to improperly avoid forever taxation of amounts that had escaped earlier taxation because of the taxpayers' methods of accounting. Pursell v. Commissioner, 38 T.C. 263, 271 (1962), affd. 315 F.2d 629 (CA3 1963). We are satisfied that respondent's approach correctly applies both the law and the policy.

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Petitioner does not contest (and thus, apparently concedes), that if we conclude (as we have), that the customer deposits are includable in income as advance payments, then a change in petitioner's method of accounting occurred and an adjustment under section 481 is required. Rather, petitioner's only contention is that respondent incorrectly calculated the amount of the adjustment required under section 481. Petitioner argues that respondent, in making his calculation:

> totally overlooked the nature of the customer deposits as individual transactions. Pursuant to the order of [PSC], on or immediately following January 1, 1972, petitioner refunded all deposits to customers having satisfactory payment records for more than 24 months, and continued such refunds through the remainder of FYE 8/31/72. Thus, with the negligible exception of deposits of customers with unsatisfactory payment records, no deposit on hand on 8/31/72 had been held by the [petitioner] for more than 24 months, i.e. since September 1, 1970. Petitioner earnestly maintains that the customer deposits are not advance payments at all; but if they should be held to be income, none of the customer deposits on the books prior to 9/1/70 can properly be considered, and the most that should be found to be attributable to the deposits on hand on 8/31/72 would be the excess of the $232,420 on hand at 8/31/72 over the balance on September 1, 1970 of $229,905. [See table 1, supra.]

We agree essentially with respondent.

Section 481(a)[22] requires that adjustments be made to the

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SEC. 481. ADJUSTMENTS REQUIRED BY CHANGES IN METHOD OF ACCOUNTING.

(a) General Rule.--In computing the taxpayer's taxable income for any taxable year (referred to in this section as the "year of the change")--

(1) if such computation is under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed, then

(footnote continued)

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extent necessary to avoid double-counting or omissions when a taxpayer's method of accounting is changed.

To calculate the section 481 adjustment, respondent in essence subtracted the opening balance of the customer deposit account in an earlier year (petitioner's taxable year 1954)[23] from the ending balance of the account in the year before the year of change in method of accounting (taxable year 1972) and adjusted the difference for the cost of the gas to arrive at a net adjustment. Respondent then made the same sort of calculation using the opening and closing balances in the year of change (taxable year 1973) and added that adjustment to the 1954-1972 adjustment. The ending balance of the account is calculated by taking the opening balance of the account for the particular year, adding to it the customer deposits received and subtracting from it the customer deposits refunded or credited to customers. (See table 1, supra.) Respondent's approach to calculating the section 481 adjustment is the equivalent of adding up all the amounts of customer deposits received for the

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(footnote continued from previous page)

(2) there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted, except there shall not be taken into account any adjustment in respect of any taxable year to which this section does not apply unless the adjustment is attributable to a change in the method of accounting initiated by the taxpayer.

23 The opening balance that respondent used in the notice of deficiency was as of September 1, 1953, or the beginning of petitioner's taxable year 1954.

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We do have one problem, however, with respondent's calculation--the year respondent used for purposes of the opening balance. If a change in method of accounting is initiated by respondent, rather than initiated by the taxpayer, then the last clause of section 481(a)(2) (in combination with section 7851(a)(1)(A)) forbids respondent to take into account adjustments "based on amounts which were taken into account in computing income (or which should have been taken into account had the new method of accounting been used) for taxable years beginning before January 1, 1954, or ending before August 17, 1954." Section 1.481-1(a)(2), Income Tax Regs. The opening balance used by respondent was as of September 1, 1953, which was the beginning of petitioner's fiscal 1954 year. Under the regulation, however, petitioner's first taxable year which did not begin before January 1, 1954, or end before August 17, 1954, is taxable year 1955, which began September 1, 1954. Thus, the opening balance which respondent should have used was the opening balance as of September 1, 1954, and not as of September 1, 1953 (see n. 23, supra). We direct the parties to address this matter in the Rule 155 computation.

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We hold for respondent on this issue, with the above-described modification.[24] To reflect the foregoing and the settlement of other issues,

Decision will be entered under Rule 155.

[24] Petitioner has not claimed the benefits of the ameliorative provisions of subsections (b) and (c) of section 481, and so we do not address the applicability of these provisions.

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T. C. Memo. 1986-119

UNITED STATES TAX COURT

PAUL C. HUFNAGLE AND G. PHYLLIS HUFNAGLE, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 15700-84. Filed March 24, 1986.

Paul C. Hufnagle, pro se.

Mark Pridgeon, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

FAY, Judge: With respect to petitioners' 1980 Federal income tax, respondent determined a deficiency of $5,257 and an addition to tax of $263 under section 6653(a).[1] After

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

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concessions, the issues are: (1) whether petitioners must include in gross income a management fee in the amount of $12,000; (2) whether petitioners must include in gross income as a constructive dividend the amount of certain payments made by petitioner Paul C. Hufnagle's wholly owned corporation; (3) whether petitioners are entitled to exemptions for their two oldest children as dependents under section 151; and (4) whether petitioners are liable for an addition to tax under section 6653(a).

FINDINGS OF FACT

Some of the facts have been stipulated and are so found.

Petitioners, Paul C. and G. Phyllis Hufnagle, resided in Bloomington, Minnesota when they filed their petition herein.

Petitioner Paul C. Hufnagle (herein, "petitioner") owns all the outstanding stock of Vic Sather and Associates, Inc., a Minnesota corporation (herein, "Associates"). Associates is a holding company and is responsible for the management and operation of the Franklin State Bank of Franklin, Minnesota.

On August 15, 1980, Associates issued a check, payable to the order of petitioner, in the amount of $12,000. This check was drawn on Associates' account at the American State Bank of Bloomington (Minnesota), and represented compensation for management services rendered by petitioner during the first half of 1980. A copy of the August 15, 1980 check was attached to the stipulation of facts. The front of the check was stamped "PAID -

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American State Bank-Sep. 22 80," while the reverse side was stamped "Credited to account of within named payee-Endorsement guaranteed."

During the year in issue, Associates made payments totalling $3,544.37 to meet the educational expenses of three of petitioners' children, Paul J. Hufnagle (herein "Paul"), Mary P. Hufnagle (herein, "Mary"), and Timothy P. Hufnagle (herein, "Timothy").[2] In September 1980, petitioner approved a resolution as the corporation's sole shareholder by which Paul, Mary and Timothy were elected as directors of Associates. At the time, Paul was 22 years old and was enrolled as a full-time student at the College of St. Thomas, located in St. Paul, Minnesota, Mary was 21 years old and was enrolled as a full-time student at the College of St. Benedict near Collegeville, Minnesota, and Timothy was 19 years old and was enrolled as a full-time student at Mankato State University in Mankato, Minnesota. Both Mary and Timothy resided away from home, at or near their respective

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[2] The education-related payments to or on behalf of petitioners' children were as follows:

Date	On behalf of	Payee	Amount
March 4, 1980	Mary	College of St. Benedict	$1,633.97
March 25, 1980	Mary	College of St. Benedict	100.00
July 8, 1980	Paul	Growe Learning Center	300.00
November 7, 1980	Paul	Paul J. Hufnagle	1,000.00
December 17, 1980	Timothy	Mankato State University	510.40

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In addition to other items not here in dispute,[5] respondent determined in his notice of deficiency: (1) that petitioners were required to include in gross income a management fee from Associates in the amount of $12,000; (2) that payments by Associates for educational expenses on behalf of Paul, Mary and Timothy, for credit card charges, for petitioner's health club membership and for season football tickets, totaling $5,337, represented the payment of petitioners' personal expenses and thus constituted a constructive dividend includible in the gross income of petitioners; (3) that petitioners were not entitled to exemptions under section 151 for Paul and Mary; and (4) that petitioners were liable for an addition to tax under section 6653(a) in the amount of $263.

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[5] In his notice of deficiency, respondent decreased petitioners' deduction for medical expenses by $546, based upon his determination of petitioners' adjusted gross income for the year in issue. The propriety of this adjustment is derivative and depends solely upon our resolution of the issues set forth herein.

In his notice of deficiency, respondent also determined a liability for self-employment tax in the amount of $1,855 on the part of petitioner Paul C. Hufnagle, and in the amount of $101 on the part of petitioner G. Phyllis Hufnagle. On their original joint Federal income tax return for 1980, petitioners had shown a liability for self-employment tax in the respective amounts of $1,855 and $97. However, on their amended return, petitioners did not show any self-employment tax liability. Except insofar as their liability for self-employment tax is affected by the includibility of the $12,000 management fee referred to herein, petitioners have not introduced evidence on this point or otherwise addressed it, and are thus deemed to have conceded the issue. See Rule 34(b)(4).

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OPINION

Issue 1. - Management Fee

Respondent has determined that petitioners must include in gross income for the year in issue a management fee from Associates in the amount of $12,000. Petitioners bear the burden of proving error with respect to this determination. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a).

Both parties recognize the fundamental principle that gross income includes compensation for services. See section 61(a)(1). Further, they agree that during 1980, Associates owed to petitioner a management fee of $12,000 for services rendered during the first half of that year. Respondent asserts that petitioner received this fee from Associates by means of the August 15, 1980 check. Petitioners contend that petitioner never received the $12,000 check from Associates. They claim that Associates lacked sufficient funds, and simply deposited the check to its own account.[6] Upon consideration of the record, we find that the preponderance of the evidence indicates that petitioner in fact received and negotiated the check in question. Accordingly, we reject petitioners' contention, and hold for respondent on this issue.

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[6] Petitioners contend that the check was deposited by Associates in order to clear this item from its account. They acknowledge that the same result could have been obtained if Associates had simply cancelled the check.

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Petitioners' contention is again directly contradicted by the documentary evidence in the record, which reflects that the check in question was stamped "PAID" by the American State Bank. From this evidence, we must infer that Associates had sufficient funds for the check to be paid by the bank. Petitioners did not present any convincing evidence to the contrary in support of their position.[7] Thus, since petitioners have failed to establish that Associates lacked sufficient funds to pay the August 15, 1980 check, we reject their argument on this point.

In conclusion, we find that petitioners have failed to prove error with respect to respondent's determination. Accordingly, we hold that they are required to include in gross income for the year in issue the $12,000 management fee from Associates.

Issue 2. - Constructive Dividends

Respondent has determined that certain expenditures by Associates constituted the payment by that corporation of petitioners' personal expenses, and that the amount thereof is thus includible in the gross income of petitioners as a

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7 Petitioners failed to present any statements from the American State Bank pertaining to Associates' account. The only relevant evidence offered by them on this point was the check register maintained by Associates. This register does not consistently reflect a current account balance. Moreover, even if we were to assume that the amount of the August 15, 1980 check had exceeded the balance in the account, it has not been shown that Associates had no other resources or available credit by which the check could have been paid.

constructive dividend. Petitioners bear the burden of proving error with respect to respondent's determination. Welch v. Helvering, supra; Rule 142(a).

Under section 61(a)(7), gross income includes dividends. The term "dividend" is defined in section 316(a) as a distribution of property by a corporation to its shareholders out of its earnings and profits. There is no requirement that the dividend be formally declared or even intended by the corporation. See, e.g., Sachs v. Commissioner, 277 F.2d 879 (8th Cir. 1960), affg. 32 T.C. 815 (1959).

It is well established that expenditures made by a corporation for the personal benefit of its shareholders may result in the receipt by the shareholders of a constructive dividend. See, e.g., Sachs v. Commissioner, supra; Greenspon v. Commissioner, 229 F.2d 947 (8th Cir. 1956), affg. in part and revg. in part on another issue 23 T.C. 138 (1954); Nicholls, North, Buse Co. v. Commissioner, 56 T.C. 1225 (1971); Ashby v. Commissioner, 50 T.C. 409 (1968); Challenge Manufacturing Co. v. Commissioner, 37 T.C. 650, 663 (1962). Amounts will not escape taxation simply because they fail to pass through the hands of the shareholder. Based upon assignment of income principles, as enunciated in Helvering v. Horst, 311 U.S. 112 (1940), the shareholder is taxable on the distribution of corporate earnings made at his demand or request to a third person for some purpose or obligation which he wished to fulfill even though he, himself, may have personally received no direct benefit. See, e.g.,

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colleges, during the year in issue.[3]

In addition to the education-related payments described above, Associates also made various other expenditures during the year in issue. Those which are relevant herein consist of credit card payments totaling $1,301.00,[4] a payment of $122.00 to the Sports and Health Club to cover the cost of petitioner's membership in such club for 1980, and a payment of $370.00 to the University of Minnesota in connection with the purchase of season football tickets.

For the year in issue, petitioners filed an original and an amended joint Federal income tax return. Petitioners included the $12,000 management fee represented by the August 15, 1980 check from Associates in gross income on their original return, but eliminated this amount from gross income on their amended return. On their original and amended returns, petitioners claimed exemptions for each of their children, including Paul and Mary, as dependents under section 151.

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[3] According to the parties' stipulation of facts, Collegeville, Minnesota and Mankato, Minnesota are approximately 75 miles and 78 miles, respectively, from the Minneapolis/St. Paul area in which petitioners resided.

[4] On January 26, 1980, Associates made a payment of $769.00 in connection with its American Express card account and on July 8, 1980 made a payment of $532.00 with respect to its "VISA" credit card. The record does not reflect the purpose of these payments.

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The record contains a copy of the August 15, 1980 check, which was payable to the order of petitioner. The face of the check was stamped "PAID" by the American State Bank, while the reverse side was stamped "Credited to the account of the within named payee-Endorsement guaranteed." This document is persuasive evidence that the check was actually received and deposited by petitioner to his own account. In an effort to refute this evidence, petitioner testified that the check in question was not received by him, but rather, was deposited by Associates to its own account. However, we found his testimony on this issue to be vague and confused and, at times, contradictory. Under such circumstances, we are obviously not required to accept petitioner's testimony as gospel and may, therefore, properly accord it little weight. See, e.g., Dougherty v. Commissioner, 60 T.C. 917, 932-933 (1973). Apart from such testimony, petitioners presented no evidence, such as bank statements or other documentation, in support of their position and have failed to show that petitioner did not receive and negotiate the August 15, 1980 check.

In what we perceive to be an alternative argument, petitioners contend that, even if petitioner received the August 15, 1980 check, Associates lacked sufficient funds to pay such check. Accordingly, petitioners argue that they need not include the amount of the check in gross income.

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Sachs v. Commissioner, supra; Byers v. Commissioner, 199 F.2d 273 (8th Cir. 1952), affg. a Memorandum Opinion of this Court; Nicholls, North, Buse Co. v. Commissioner, supra. Controlling shareholders have thus been held to have received constructive dividends where corporate payments are made at their direction to or on behalf of family members. See, e.g., Byers v. Commissioner, supra; Nicholls, North, Buse Co. v. Commissioner, supra.

The classification of an expenditure as a constructive dividend is a question of fact to be determined in each case. Hardin v. United States, 461 F.2d 865 (5th Cir. 1972), revg. an unreported District Court opinion; Lengsfield v. Commissioner, 241 F.2d 508 (5th Cir. 1957), affg. a Memorandum Opinion of this Court. In pursuing this inquiry, courts have consistently used a two-pronged test. First, the corporation must have conferred an economic benefit without expectation of repayment. See United States v. Smith, 418 F.2d 589 (5th Cir. 1969), revg. and remanding 266 F. Supp. 814 (S.D. Tex. 1967). Second, the corporation-provided benefit must primarily advance the shareholder's personal interest as opposed to the business interests of the corporation. Ireland v. United States, 621 F.2d 731 (5th Cir. 1980), affg. in part and revg. and remanding in part an unpublished District Court opinion; Sammons v. Commissioner, 472 F.2d 449 (5th Cir. 1972), affg. on this point a Memorandum Opinion of this Court.

that this expenditure had any relationship to the business interests of the corporation, rather than petitioner's personal interest.

Accordingly, we hold that these amounts are properly includible in petitioners' gross income as constructive dividends.

C. Payment for Season Football Tickets.

During the year in issue, Associates paid $370 to the University of Minnesota in connection with the purchase of season football tickets. Respondent determined this amount to be includible in petitioners' gross income as a constructive dividend.

After reviewing the record, we find that, of the total amount paid to the University of Minnesota, the sum of $262 represents a bona fide corporate expenditure and is therefore not properly taxable to petitioners. Petitioner admitted at trial that he had no recollection concerning the remaining $108 of this expenditure. Since petitioners have thus failed to satisfy their burden of proof as to this latter amount, we sustain respondent's determination to the extent of $108.[9]

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9 Petitioners assert on brief that the various amounts in issue cannot constitute constructive dividends because Associates lacked sufficient earnings and profits during the year in issue. Their contention lacks factual support in the record, however, and we accordingly reject it.

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With these criteria in mind, we turn to the question of whether the amounts listed by respondent in his notice of deficiency were properly determined to be constructive dividends.

A. Education-related payments

During the year in issue, Associates paid a total of $3,544.37 to meet the college educational expenses of petitioners' children, Paul, Mary and Timothy. Respondent determined this amount to be taxable to petitioners as a constructive dividend.

It is abundantly clear from the record that petitioner, by virtue of his control over Associates, directed the corporation's payment of his children's educational expenses. These payments indisputably conferred an economic benefit upon petitioners and their family. Petitioner admitted at trial that he felt a "moral" obligation to pay the costs of his childrens' education and that, during the years prior to 1980, he personally paid such expenses. By causing Associates to make such payments, petitioner obtained a personal economic advantage, as well as the fulfillment of his parental desire to afford educational opportunities to his children.

Petitioners assert that the education-related payments served legitimate corporate purposes. First, they argue that such expenditures better enabled the children to carry out their duties as directors of the corporation. Alternatively, petitioners argue that these amounts were intended to compensate the children for services rendered to Associates. These

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B. Payments for credit card charges and health club membership.

During the year in issue, Associates made payments totalling $1,301 with respect to its credit cards, and a payment in the amount of $122 for petitioner's health club membership. Respondent determined these amounts to be includible in petitioners' gross income as constructive dividends.

Petitioners introduced no evidence concerning the credit card payments in issue, and have thus failed to satisfy their burden of proof as to these expenditures.

On this record, we must also sustain respondent's determination concerning Associates' payment of petitioner's health club membership. The parties have stipulated that this membership was for petitioner in his individual capacity, and it is thus clear that an economic benefit was conferred upon petitioner by reason of this payment. Petitioners have not shown

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(footnote continued from previous page)
there is no evidence in the record of respondent's purported determination concerning the childrens' returns. Moreover, estoppel is an affirmative defense which must be pleaded and proved. See Southern Pacific Transportation Co. v. Commissioner, 75 T.C. 497, 838 (1980); Lodi Iron Works, Inc. v. Commissioner, 29 T.C. 696 (1958); see also Rule 39. Petitioners failed to raise any issue of estoppel in their petition. In any event, even if the issue of estoppel were properly before us, petitioners have not shown, as they must to successfully invoke that doctrine, that they acted or relied to their detriment upon respondent's purported determination concerning the childrens' returns for the years in issue. Cf. Knapp-Monarch Co. v. Commissioner, 139 F.2d 863 (8th Cir. 1944). Accordingly, we find no merit in petitioners' estoppel argument.

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contentions are unsupported by the record. During the year in issue, Mary and Timothy were away from home attending college full-time, and Paul was also a full-time student. We are not persuaded that these children, although named as directors, played any meaningful role in the corporate affairs of Associates or that their education furthered the business interests of that corporation. Similarly, we do not discern from this record any services performed by Paul, Mary or Timothy which would justify the payment of expenses on their behalf of the type involved here.

After considering the record, we conclude that Associates' payment of educational expenses on behalf of Paul, Mary and Timothy was not made in furtherance of bona fide corporate purposes. Rather, such payment was simply a means for petitioner to, in effect, divert the earnings of his wholly owned corporation to his children, thereby conferring an economic benefit in satisfaction of his parental desires. Cf. Byers v. Commissioner, supra. Accordingly, we hold that the amount so expended by Associates is properly includible in petitioners' gross income as a constructive dividend.[8]

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8 On brief, petitioners assert that respondent had previously determined, in connection with examinations of the returns of Paul, Mary and Timothy for the year in issue, that the education-related payments represented taxable income to the children. Accordingly, petitioners argue that respondent is estopped herein from determining that these payments are taxable to petitioners as a constructive dividend.

First, we note that, other than petitioner's own assertions, (footnote continued)

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Issue 3. - Dependency Exemptions

Respondent determined in his notice of deficiency that petitioners are not entitled to exemptions for their two oldest children, Paul and Mary, as dependents under section 151. However, he concedes on brief that they may claim exemptions for Paul and Mary in the event that the education-related payments made by Associates on behalf of the children are determined to be a constructive dividend to petitioners. Since we have found such payments to be properly includible in their gross income as constructive dividends, we hold, in light of respondent's concession, that petitioners are entitled to exemptions for Paul and Mary as dependents under section 151.

Issue 4. - Addition to tax under section 6653(a)

Respondent has determined that petitioners are liable for an addition to tax in the amount of $263 under section 6653(a). That provision imposes an addition to tax equal to 5 percent of the underpayment if any part thereof is due to negligence or intentional disregard of rules and regulations. Petitioners bear the burden of proving respondent's determination on this issue to be incorrect. Enoch v. Commissioner, 57 T.C. 781, 802 (1972). After considering the record, we conclude that they have failed to sustain their burden of proof on this issue. Accordingly, we sustain the imposition of the addition to tax under section 6653(a).

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To reflect concessions and the foregoing,

Decision will be

entered under Rule 155.

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6653(b)[1] of the Internal Revenue Code in the amounts of $1,153.50 and $1,388.00 for those years, respectively.

The only issue is whether petitioners are liable for the addition to tax under section 6653(b) with respect to deficiencies, now conceded, resulting from "war tax" deductions claimed by petitioners because of their religious beliefs.

FINDINGS OF FACT

The stipulations of facts and the exhibits attached thereto are incorporated herein by this reference.

Petitioners resided in Warwick, Rhode Island at the time they filed the petition herein.

During the years 1980 and 1981, both petitioners were employed as school teachers, S. Kevin Regan ("Kevin") by La Salle Academy in Providence, Rhode Island, and petitioner Linda G. Regan ("Linda") by Our Lady of Mercy Church in East Greenwich, Rhode Island. Petitioners are devout Roman Catholics. They devote much of their lives to the work of the church and to helping the needy, hungry, and less fortunate people in the community. Petitioners believe that it is morally wrong to pay taxes which would be used for the purpose of building arms, strengthening national defense, preparing for war, and ultimately annihilating human beings. The returns petitioners timely filed reflected the amount of wages and interest income received and set forth various deductions on the Schedule A. Because of their

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

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T. C. Memo. 1986-120

UNITED STATES TAX COURT

S. KEVIN REGAN AND LINDA G. REGAN, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 1791-83. Filed March 25, 1986.

Louis J. Vallone, for petitioners.

Thomas C. Boscarino, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

CLAPP, Judge: Respondent determined deficiencies in income tax for the years 1980 and 1981 in the amounts of $2,307.00 and $2,776.00, respectively, and additions to tax under section

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beliefs, they took deductions for "war tax credits" and for "Rhode Island Alternative Fund For Peace and Human Needs," which deductions resulted in their having no tax liability for these years. Petitioners attached to each of these returns lengthy statements with respect to their war tax credit deductions which set forth their moral and religious position regarding that deduction as well as statements of the position of the Catholic Church and the Gospel of St. Matthew. On their 1981 return, they underlined the deduction for "war tax credit" and circled the line number on which it appeared in order to call attention to the deduction.

The Rhode Island Alternative Fund For Peace and Human Needs was a Rhode Island non-business corporation created in 1979 which had among its purposes:

> providing personal and organizational support to those who seek a reordering of national economic priorities away from high military spending to the meeting of domestic human needs, especially those who withhold payment of all or part of their federal income or excise taxes as a protest against military spending and preparation for war.

There is no evidence in the record that this organization had ever applied for, or been granted, tax exempt status by the Internal Revenue Service.

Petitioners had taken similar deductions on their tax returns for the years 1977, 1978, and 1979, all of which were challenged by respondent, and all of which ended up in the Tax Court for decision. The proceedings for the year 1977 came to a conclusion on May 22, 1980 when this Court issued an order

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affirming its order dismissing the petition for failure to state a claim upon which relief can be granted, in which petitioners were advised that there is no statutory provision authorizing the allowance of a war tax credit. This proceeding was concluded prior to the filing of tax returns for the years at issue. With respect to the years 1978 and 1979, a notice of deficiency was issued on March 11, 1981, which also was appealed to the Tax Court. This case was concluded by an order and decision dated August 6, 1982, which found against petitioners for the reasons set forth in the memorandum sur order served therewith. The administrative proceedings in which petitioners were once again made aware of the state of the law with respect to war tax credits with respect to the years 1978 and 1979 were concluded prior to the due date for filing the earliest of the returns here at issue. With respect to all of the years 1977, 1978, and 1979, additions to tax were assessed under section 6653(a) for negligence or intentional disregard of rules or regulations, and with respect to the years 1978 and 1979, the Tax Court awarded damages pursuant to section 6673 relating to proceedings instituted by the taxpayer for delay. Petitioners were aware prior to filing their income tax returns for the years 1980 and 1981 that the law did not allow a deduction for a war tax credit based upon religious beliefs.

Both petitioners filed Forms W-4, Employee's Withholding Allowance Certificates, with their employers with respect to the years at issue, which claimed exemption allowances up to thirteen

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in number and far in excess of the four exemption allowances to which they were entitled and which were claimed on their income tax returns. Linda filed one such form on January 31, 1979 on which it was written "No withholding tax being withheld-form being filed on Income Tax Return." As a result of these Forms W-4, Kevin had income tax withheld in the amounts of $4.73 and $47.91 for the years 1980 and 1981, respectively, and Linda had no Federal income tax withheld for either year.

The underpayments of income tax for the years 1980 and 1981 were not due to fraud with intent to evade tax.

OPINION

Petitioners in their petition did not challenge the correctness of respondent's determination that they were not entitled to a deduction for a "war tax credit." Therefore, the only issue remaining is whether petitioners are liable for the section 6653(b) additions to tax for fraud.

The burden of proving fraud is on respondent and he must carry his burden by clear and convincing evidence. Section 7454(a); Rule 142(b), Tax Court Rules of Practice and Procedure. He must show that petitioners intended to evade taxes which they knew or believed they owed by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes. Rowlee v. Commissioner, 80 T.C. 1111, 1123 (1983). The presence or absence of fraud is factual, to be determined upon consideration of the entire record. Gajewski v. Commissioner, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d

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1383 (8th Cir. 1978). Since fraud can seldom be established by direct proof of intention, the taxpayer's entire course of conduct is often relied on to establish circumstantially such fraudulent intent. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971).

In this case petitioners filed timely tax returns which set forth clearly the deductions for "war tax credits," and also attached statements and other materials which clearly set forth petitioners' position. We have found that by the time they filed the returns here at issue, petitioners knew that there was no proper deduction for a "war tax credit" based upon their religious views no matter how sincerely those views were held. We believe that petitioners did sincerely hold their religious views and that their statements were not merely a facade to cover up what was basically a selfish unwillingness to pay their fair share of taxes. Petitioners did not attempt to conceal their deduction or the reasons therefore.

In Muste v. Commissioner, 35 T.C. 913 (1961), this Court found that a finding of fraud was not warranted where the taxpayer did not attempt to conceal from respondent the fact that he had income but rather advised respondent at the time for filing of the returns that he did not intend to file returns. His stated reason was his sincere belief that he should not pay taxes because he was opposed to the use of Federal funds for war. The Court stated:

> We are completely satisfied that there was not on the part of the petitioner any bad faith, intentional wrongdoing, sinister motive, or intent to mislead or

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> deceive the respondent. Under these circumstances it is our conclusion, and we have found as a fact, that no part of the deficiency in tax for any year in question was due to fraud with intent to evade tax. [35 T.C. at 921.]

Here, respondent cites as indicia of fraud petitioners' lack of cooperation during the examination and litigation stages. However, there is no probative evidence in the record of a lack of cooperation on petitioners' part. While conduct subsequent to the tax years in question can be indicative of a taxpayer's fraudulent intent, pursuit of this litigation by petitioners' counsel cannot be said to be so indicative.

Respondent relies on the fact that petitioners filed false Forms W-4 and cites a series of cases where this fact was considered indicative of fraudulent intent to evade taxes. While we cannot condone petitioners' actions in filing incorrect Forms W-4, we note that the cases relied upon by respondent involved other actions, such as failure to file returns, which constituted a course of conduct intended to conceal tax liability and mislead and deceive respondent. Here, however, under this particular record, we do not have such a pattern of concealment. Respondent has failed to provide any basis for distinguishing this case from Muste v. Commissioner, supra. Accordingly, we find no part of the deficiencies are due to fraud under section 6653(b).[2]

An appropriate decision will be entered.

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[2] The record clearly supports a finding of intentional disregard of the rules and regulations under section 6653(a). Respondent, however, has not requested this alternative relief.

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Year	Deficiency	Addition to Tax Section 6653(a)[2]
1973	$ 3,038.00	$ -
1974	6,652.44	-
1975	5,876.00	-
1976	10,302.45	515.12
1977	8,340.70	470.69
1978[3]	1,917.37	95.87

After concessions, the issues remaining for decision are:

(1) Whether petitioners are entitled to deductions in excess of those allowed by respondent for automobile expenses, travel expenses, and employee business expenses;

(2) Whether petitioners are entitled to casualty losses from a theft of certain personal property, the loss of a black opal stone, and/or the breakage of water lines on two separate occasions;

(3) Whether petitioners are entitled to deductions in excess of those allowed by respondent for charitable contributions and medical expenses;

(4) Whether petitioners are entitled in 1973, 1974 and 1975 to certain capital loss carryovers, and in 1976, 1977 and 1978 to a deduction from a worthless nonbusiness bad debt;

(5) Whether petitioners are entitled to investment tax credit in 1976, 1977 and 1978; and

---

2 All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue unless otherwise indicated. All rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise provided.

3 The deficiency and addition to tax for 1978 is due from petitioner Robert F. Neece only (docket No. 16603-81). The deficiencies and additions to tax for all other years are the joint liability of both petitioners (docket Nos. 14786-81 and 16602-81).

(6) Whether additions to tax under section 6653(a) are due for the years 1976, 1977 and 1978 because of petitioners' negligence or intentional disregard for applicable rules and regulations.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found, the stipulations and related exhibits being incorporated herein by reference.

Petitioners, Robert F. Neece and Gay F. Neece, husband and wife, filed joint income tax returns for 1973 through 1977. Robert F. Neece filed a married-filing-separately return for 1978. All of the returns were filed with the Kansas City Service Center. Both petitioners resided in St. Louis, Missouri, on the dates the petitions were filed herein.

(1) Automobile, Travel and Employee Business Expenses

During the years in issue, petitioner[4] was employed as a salesman and sales manager for Paramount Television Sales, Inc. (Paramount), a separate corporation owned by Paramount Pictures. Throughout 1973 and part of 1974, he leased and used for business purposes a 1972 Lincoln Mark IV. However, on October 4, 1974, he bought the Lincoln from the lessor and thereafter used it solely for personal purposes.

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[4] All references to petitioner in the singular will be to Robert F. Neece, unless otherwise indicated.

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Beginning in November 1974 and continuing throughout 1975, 1976 and 1977 petitioner leased and used for business purposes a 1975 Cadillac Eldorado. During 1978, he owned and used in connection with his employment a new 1978 Mercury.

For the years 1973 through 1978, petitioners claimed and respondent allowed and disallowed deductions for automobile expenses as shown in Schedule 1:

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SCHEDULE 1

AUTOMOBILE EXPENSES

Item	1973 Amount Claimed	1973 Amount Allowed	1973 Amount Disallowed	1974 Amount Claimed	1974 Lincoln Mark IV Amount Allowed	1974 Cadillac Amount Allowed	1974 Amount Disallowed	1975 Amount Claimed	1975 Amount Allowed	1975 Amount Disallowed
Leasing of Car	$2,884.92	$2,884.92	$ -	$2,901.35	$2,163.69[3]	$ 612.66[4]	$ 125.00	$3,676.56	$3,676.56	$ -
Gasoline, Oil and Grease	787.00	393.82[1]	393.18	772.56	353.33[5]	54.41[6]	364.82	789.05	475.80	313.25
Repairs	691.07	631.50	59.57	680.77	390.09	-	290.68	386.19	68.05	318.14
Licenses	30.50	-	30.50	57.50	-	-	57.50	32.00	-	32.00
Inspection	2.50	-	2.50	7.00	-	-	7.00	3.00	-	3.00
Triple A Membership	30.00	-	30.00	30.00	-	-	30.00	30.00	-	30.00
Driver's License	3.40	-	3.40	-	-	-	-	-	-	-
Ladue City Sticker	5.00	-	5.00	5.00	-	-	5.00	5.00	-	5.00
Insurance	217.00	217.00	-	373.50	108.50	-	265.00	475.00	139.00	336.00
Wash	150.00	-	150.00	250.00	-	-	250.00	250.00	-	250.00
Depreciation	-	-	-	-	-	-	-	-	-	-
TOTALS	$4,801.39	$4,127.24	$ 674.15	$5,077.68	$3,015.61	$ 667.07	$1,395.00	$5,646.80	$4,359.41	$1,287.39
TIMES: PERCENT USED IN BUSINESS	100%	79%	100% x 674.15 21% x 4,127.24	100%	51%	97%	100% x 1,395.00 49% x 3,015.61 3% x 667.07	100%	100%	100%
SUBTOTALS	$4,801.39	$3,260.52	$1,540.87	$5,077.68	$1,537.96	$ 647.06	$2,892.66	$5,646.80	$4,359.41	$1,287.39
LESS: AMOUNT REIMBURSED BY EMPLOYER	(731.97)	(731.97)	-	(475.50)	(475.50)	-	-	(731.90)	(731.90)	-
GRAND TOTALS	$4,069.42	$2,528.55	$1,540.87[2]	$4,602.18	$1,062.46	$ 647.06	$2,892.66	$4,914.90	$3,627.51	$1,287.39

[1] The business use amount allowed, $311.12, divided by 79 percent.

[2] The stipulations vary as to the total amount disallowed by respondent, at times incorrectly stating the amount as $1,573.89.

[3] The business use amount allowed, $1,103.48, divided by 51 percent.

[4] The business use amount allowed, $ 594.28, divided by 97 percent.

[5] The business use amount allowed, $ 180.20, divided by 51 percent.

[6] The business use amount allowed, $ 52.78, divided by 97 percent.

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SCHEDULE 1

AUTOMOBILE EXPENSES

Item	1976 Amount Claimed	1976 Amount Allowed	1976 Amount Disallowed	1977 Amount Claimed	1977 Amount Allowed	1977 Amount Disallowed	1978 Amount Claimed	1978 Amount Allowed	1978 Amount Disallowed
Leasing of Car	$3,676.56	$3,675.36	$ 1.20	$3,776.78	$3,776.78	$ -	$ -	$ -	$ -
Gasoline, Oil and Grease	693.19	685.30	7.89	794.32	794.32	-	558.19	558.19	-
Repairs	369.77	259.64	110.13	374.48	374.48	-	264.21	264.21	-
Licenses	-	-	-	-	-	-	26.10	26.10	-
Inspection	-	-	-	2.50	2.50	-	3.00	3.00	-
Triple A Membership	20.00	-	20.00	36.00	36.00	-	26.00	36.00	-
Driver's License	-	-	-	-	-	-	-	-	-
Ladue City Sticker	-	-	-	-	-	-	5.00	5.00	-
Insurance	351.86	-	351.86	290.00	-	290.00	291.00	-	291.00
Wash	300.00	-	300.00	300.00	-	300.00	300.00	-	300.00
Depreciation	-	-	-	-	-	-	226.28	226.28	-
TOTALS	$5,411.38	$4,620.30[2]	$ 791.08	$5,574.08	$4,984.08	$ 590.00	$1,709.78[4]	$1,118.78[5]	$ 591.00
TIMES: PERCENT USED IN BUSINESS	90%	50%	90% x 791.08 40% x 4,620.30	90%	50%	90% x 590.00 40% x 4,984.08	90%	50%	90% x 591.00 40% x 1,118.78
SUBTOTALS	$4,870.24	$2,310.15	$2,560.09	$5,016.67	$2,492.04	$2,524.63	$1,538.80	$ 559.39	$ 979.41
LESS: AMOUNT REIMBURSED BY EMPLOYER	(674.30)	(674.30)	-	(910.70)	(910.70)	-	(345.28)	(345.28)	-
GRAND TOTALS	$4,195.94[1]	$1,635.85	$2,560.09	$4,105.97[3]	$1,581.34	$2,524.63	$1,193.52	$ 214.11	$ 979.41

1 Petitioners have conceded that an additional $2,798.06 in claimed automobile deductions related to Mrs. Neece's use of a 1976 Lincoln Continental are not deductible in 1976.

2 The stipulations incorrectly add the expenses to arrive at a total amount allowed of $4,619.96.

3 Petitioners have conceded that an additional $871.10 in claimed automobile deductions related to Mrs. Neece's use of a 1976 Lincoln Continental are not deductible in 1977.

4 In claiming the automobile deduction, petitioner, Robert Neece, incorrectly misstated the total by $10.00. This error arises from a discrepancy in the amount claimed for the Triple A Membership.

5 The stipulations vary as to the total amount substantiated by $10.00.

During the years 1973 through 1978, petitioner was primarily responsible for Paramount's sales in the Midwest, South and Southwest but he traveled throughout the United States selling television programming and motion pictures. For about forty-five weeks during each year petitioner spent four or five days per week away from home. He usually left on Monday and returned on Thursday or Friday.

Petitioner testified that during these years and as part of his employment he spent money entertaining customers both at home and away from home, that he was required by Paramount to provide a suitable place to store films, brochures, rating books, sales materials and office supplies, and that he was expected to maintain an office as a base for his promotional and sales activities, including the preparation of contracts and correspondence.

He also testified that it was Paramount's policy to reimburse him for his secretary's salary and his expenditures for travel and entertainment but that he received no reimbursement for expenses incurred with respect to office and storage space which he provided in his home for Paramount. He stated that he claimed and received reimbursement for his reimbursable expenses by submitting weekly expense reports to Paramount.

In 1972 petitioners hired an architect to supervise the construction of a new garage and an addition to their residence. Petitioners claim that from 1972 to 1976 they used the new garage

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SCHEDULE 2

TRAVEL AND OTHER BUSINESS EXPENSES

	1973		1974		1975	
	Amount Claimed	Amount Disallowed	Amount Claimed	Amount Disallowed	Amount Claimed	Amount Disallowed
AUTOMOBILE EXPENSES:						
(See Schedule 1)	$ 4,069.42	$ 1,540.87	$ 4,602.18	$ 2,892.66	$ 4,914.90	$ 1,287.39
TRAVEL EXPENSES:						
Airline Fares	$ 1,207.44	$ 1,207.44	$ 857.45		$ 425.42	
Car Rentals & Taxi Cabs	487.60	487.60	188.08		434.61	
Hotel & Other Travel Expenses	1,106.74	1,106.74	821.27		1,412.38	
Additional Uncompensated Expenses	2,420.05	-	1,017.76		89.94	
SUB TOTALS	$ 5,221.83	$ 2,801.78	$ 2,884.56	$ 2,884.56	$ 2,362.35	$ 2,362.35
OTHER BUSINESS EXPENSES:						
Movies Previewed	$ 58.73	$ -	$ 117.75	$ -	$ 99.25	$ -
Entertainment of Customers	2,842.57	2,502.88	5,360.76	5,003.08	9,006.37	8,659.20
Gifts to Customers	453.88	453.88	1,308.34	1,308.34	768.04	768.04
Accounting Services	100.00	-	120.00	-	-	-
Legal Services	-	-	727.00	727.00	1,000.00	800.00
Advertising	3.75	-	35.02	-	55.53	-
Dues & Subscriptions	108.20	-	272.42	-	324.64	-
Repairs to Office & Equipment	921.73	921.73	1,120.89	1,120.89	1,987.36	1,987.36
Secretarial Services	432.96	432.96	144.00	144.00	45.00	45.00
Bank Service Charges	16.91	-	17.62	-	24.10	-
Office Supplies	85.00	-	107.95	-	86.64	-
Utilities (Building)	354.23	354.23	386.50	386.50	475.63	475.63
Telephone	32.18	-	26.89	-	-	-
Alarm Services and Security	139.69	139.69	520.24	520.24	782.79	782.79
Insurance	64.50	64.50	63.00	63.00	86.75	86.75
Maintenance & General Repair	507.32	507.32	310.64	310.64	662.31	662.31
Pool Maintenance	764.81	764.81	1,881.13	1,881.13	1,671.73	1,671.73
Utilities for Pool	284.00	284.00	354.53	354.53	398.90	398.90
Depreciation	2,926.65	2,227.55	3,651.18	2,547.79	3,982.43	2,697.39[3]
SUB TOTALS	$10,097.11	$ 8,653.55	$16,525.86	$14,367.14	$21,457.47	$19,035.10
GRAND TOTALS	$19,388.36	$12,996.20[1]	$24,012.60	$20,144.36[2]	$28,734.72	$22,684.84[4]

1 This amount varies by $32.80 from the amount disallowed in respondent's notice of deficiency.

2 The stipulations vary by $.36.

3 The stipulations incorrectly add depreciation and vary by $.49.

4 This amount varies by $.16 from the amount disallowed in respondent's notice of deficiency.

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SCHEDULE 2

TRAVEL AND OTHER BUSINESS EXPENSES

	1976		1977		1978	
	Amount Claimed	Amount Disallowed	Amount Claimed	Amount Disallowed	Amount Claimed	Amount Disallowed
AUTOMOBILE EXPENSES:						
(See Schedule 1)	$ 4,195.94	$ 2,560.09[1]	$ 4,105.97	$ 2,524.63[3]	$ 1,193.52	$ 979.41
TRAVEL EXPENSES:						
Uncompensated Expenses	$ 888.90	$ 888.90	$ 50.00	$ 50.00	$ -	$ -
OTHER BUSINESS EXPENSES:						
Movies Previewed	$ 110.00	$ 110.00	$ 91.75	$ 91.75	$ 75.76	$ 75.76
Entertainment of Customers	7,551.17	7,551.17	6,062.91	6,062.91	2,920.64	2,920.64
Gifts to Customers	407.13	407.13	181.62	181.62	145.72	145.72
Accounting Services	-	-	-	-	360.00	360.00
Legal Services	62.50	-	100.00	-	1,031.16	1,031.16
Advertising	19.24	-	27.72	-	13.64	-
Dues & Subscriptions	396.84	318.86	264.95	220.95	50.00	50.00
Repairs to Office & Equipment	1,787.05	1,787.05	2,047.86	2,047.86	1,230.73	1,230.73
Secretarial Services	-	-	-	-	-	-
Bank Service Charges	7.30	-	28.02	-	24.48	-
Office Supplies	30.11	30.11	103.08	103.08	282.31	282.31
Utilities (Building)	541.89	541.89	772.47	772.47	498.29	498.29
Telephone	89.32	89.32	-	-	-	-
Alarm Services and Security	353.58	353.58	175.82	175.82	272.28	272.28
Insurance	122.56	122.56	167.06	167.06	170.25	170.25
Maintenance & General Repair	600.04	600.04	264.30	264.30	784.42	784.42
Pool Maintenance	1,163.89	1,163.89	1,630.71	1,630.71	679.41	679.41
Utilities for Pool	425.63	425.63	444.24	444.24	336.08	336.08
Depreciation	5,796.81	4,531.44[2]	5,014.26	4,558.73[4]	5,948.42	4,947.64
SUB TOTALS	$19,465.06	$18,032.67	$17,376.77	$16,721.50	$14,823.59[5]	$13,784.69
GRAND TOTALS	$24,549.90	$21,481.66	$21,532.74	$19,296.13	$16,017.11	$14,764.10

1 This amount does not include $2,798.06 in disallowed expenses related to Mrs. Neece's automobile (see Schedule 2 footnote 1). The combined total automobile disallowance also varies by $278.12 from respondent's notice of deficiency.

2 The stipulations vary by $.10 as to the total amount of disallowed depreciation.

3 This amount does not include $871.10 in disallowed expenses related to Mrs. Neece's automobile. (See Schedule 2 footnote 3). The combined total automobile disallowance also varies by $275.00 from respondent's notice of deficiency.

4 The stipulations vary by $.16 as to the total other business expenses disallowed.

5 The total amount of other business expenses varies by $.99 on petitioner's tax return, due to an error in addition.

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UNITED STATES TAX COURT

ROBERT F. NEECE AND GAY F. NEECE, ET AL.,[1] Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 14786-81,
16602-81,
16603-81.

Filed March 25, 1986.

Edward R. Joyce, for the petitioners.

Steven W. LaBounty, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SHIELDS, Judge: Respondent determined that deficiencies in income tax and additions to tax are due from petitioners as follows:

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[1] The following cases are consolidated herewith: Robert F. Neece and Gay F. Neece, docket No. 16602-81; and Robert F. Neece, docket No. 16603-81.

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and addition exclusively for storage and office space. They also claim that during the same period another area of their house was maintained and used exclusively for an office and for storage.

In 1976 petitioners employed the same architect to supervise the construction of another garage at the north end of their house, convert the old garage into a bedroom/playroom, and add a breakfast room to the rear of their house. Between 1976 and 1978, petitioners claim they used the new garage and the same office and storage area exclusively for business purposes.

In the preparation of their tax returns, petitioners claimed that 25 percent of the residence was used for business purposes and deductions for utilities (house and pool), insurance, maintenance (house and pool), repairs, security (food and veterinary supplies for watch dog) and depreciation were computed accordingly. The swimming pool constituted a business item according to petitioners because it was a status symbol of Mr. Neece's success and permitted him to use it as an an "open invitation" to his friends and business associates.

For the years in issue, petitioners claimed and respondent disallowed deductions for travel and other business expenses as shown on Schedule 2:

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At trial respondent stipulated that petitioners had substantiated the amount and the expenditure but not the deductibility of the expenses set forth on Schedule 3 which petitioners claim as additional business expenses:

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SCHEDULE 3

OTHER EXPENSES SUBSTANTIATED

	1973	1974	1975	1976	1977	1978
Movies Previewed	$ -	$ -	$ -	$ 107.75	$ 95.75	$ 55.75
Entertainment:						
Groceries	1,226.35	1,353.13	1,864.51	1,592.71	1,346.24	447.99
Liquor	1,029.62	1,504.60	1,627.64	2,809.23	1,681.34	1,279.61
Restaurants	113.02	1,696.66	2,483.71	2,855.71	-	-
Other	76.26	493.69	2,311.92	220.00	2,464.90	777.41
SUB TOTAL:	2,445.25	5,048.08	8,287.78	7,477.65	5,492.48	2,505.01
Gifts	416.38	1,307.84	768.68	265.48	57.83	145.73
Accounting	-	-	-	-	-	360.00
Legal	-	627.00	689.50	-	-	1,031.16
Advertising	-	-	-	-	-	-
Dues	-	-	-	402.98	264.95	50.00
Repairs to Office	213.39	524.85	483.46	-	-	-
Secretarial Services	-	-	-	-	-	-
Bank Service Charge	-	-	-	-	-	-
Office Supplies	-	-	-	-	-	-
Utilities (House)	1,254.43	1,329.90	1,691.72	2,147.62	2,924.46	1,825.14
Telephone	-	-	-	-	-	-
Alarm	260.77	324.50	307.00	282.48	83.31	208.49
Security Dog	387.00	715.98	475.79	104.67	268.48	336.06
Insurance	-	-	-	465.09	668.23	-
Maintenance (House)	2,721.55	1,942.19	4,152.61	1,334.13	3,308.68	4,508.56
Pool Maintenance	1,019.57	1,929.51	2,228.97	290.88	-	890.29
Pool Utilities	378.66	354.53	531.86	547.59	426.85	442.17
GRAND TOTAL:	$ 9,097.00	$14,104.38	$19,617.37[1]	$13,426.32	$13,591.02	$12,358.36

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1 This total varies by $100.00 from the total calculated in the exhibit presented at trial.

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(2) Casualty Losses

(a) Theft of Personal Property

In November 1972, personal property was stolen from petitioners' garage. In January 1973, a proof of loss with respect to the theft was filed by petitioners with their insurance compar/, The Federal Insurance Company of New Jersey. On the proof of loss the fair market value of the stolen property was shown as $8,985.73 with a deductible amount of $500 for a net claim of $8,485.73. On a subsequent document entitled "Final Loss Adjustment and Work Sheet," which lists the items stolen as including a lawn mower, a bicycle, a circular saw, various tools, a wagon, swim fins, and boating books, the insurance company determined that while the cost of replacing the stolen items was $9,241.74, their fair market value at the time of the burglary was the $8,985.73 shown on the proof of loss. The difference of $256.01 between the cost to replace and the fair market value was referred to by the insurance company as "betterment."

On their 1973 tax return petitioners claimed a casualty loss deduction of $656.00 which is represented by the $256.01 in betterment plus the $500.00 insurance deductible less the $100.00 exclusion per incident under section 165(c)(3). Respondent allowed a casualty loss deduction in 1973 of $500.00 less the $100.00, but disallowed the deduction of the $256.00 for betterment.

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(b) Opal Stone

On May 17, 1974, Gay F. Neece, lost a black opal stone from a ring which also contained fourteen sapphires and twenty-six diamond chips. She last saw the stone at approximately 3:45 a.m. on the date of the loss while standing at the cashier's cage of Caesar's Palace, Las Vegas, Nevada. She noticed the stone was missing some time later upon returning to Circus Circus Hotel, where petitioners were staying. Upon discovering the loss, petitioners notified security guards at both hotels, searched for the stone until 7:00 a.m., and filed lost item reports and a police report.

Mrs. Neece had received the ring which held the lost stone from her father. It had originally belonged to her mother. The ring was appraised on July 26, 1967, at $1,500.00.

After going to different jewelers in an unsuccessful effort to replace the stone and discussing the matter with Mrs. Neece's father, petitioners claimed a casualty loss deduction in the amount of $5,000 on their 1974 return. Respondent disallowed the loss in its entirety.

(c) Water Damage

On their 1976 tax return, petitioners claimed an $800 casualty loss deduction with respect to two separate incidents of pipeline breakage during freezing weather. Respondent disallowed the deduction in its entirety and petitioners have offered no evidence to substantiate the claim.

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(3) Charitable Contributions and Medical Expenses

During the years in issue petitioners and their children belonged to St. Peter's Episcopal Church and regularly attended weekly services. For the years 1976 through 1978, petitioners claimed and respondent disallowed deductions for charitable contributions to the church and other charities as shown on Schedule 4:

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SCHEDULE 4

CHARITABLE CONTRIBUTIONS

ORGANIZATION:	1976			1977			1978		
	Amount Claimed	Amount Allowed	Amount Disallowed	Amount Claimed	Amount Allowed	Amount Disallowed	Amount Claimed	Amount Allowed	Amount Disallowed
St. Peters Episcopal Church	$ 500.00	$ -	$ 500.00	$ -	$ -	$ -	$ 350.00	$ 350.00	$ -
New Hope Foundation	326.20	-	326.20	600.00	-	600.00	425.00	-	425.00
St. Louis Symphony Orchestra	342.00	220.00	122.00	-	-	-	-	-	-
Salvation Army	75.00	-	75.00	-	-	-	50.00	50.00	-
Great Dane Club of Greater St. Louis	15.00	-	15.00	-	-	-	-	-	-
Sister City Benefit	30.00	-	30.00	-	-	-	-	-	-
St. Louis County Police Officers' Association	5.00	-	5.00	-	-	-	-	-	-
Villa Duchesne Christmas Baskets for the Poor	31.25	-	31.25	-	-	-	75.00	75.00	-
St. Louis Children's Hospital	-	100.00	-	-	-	-	-	-	-
Goodwill				250.00	-	250.00	-	-	-
March of Dimes				25.00	25.00	-	25.00	25.00	-
Arts and Education Council				50.00	-	50.00	-	-	-
American Narcolepsy Association				22.00	22.00	-	-	-	-
Bonne Chance Auction				206.32	112.30	94.02	-	-	-
St. Rachael's School							54.00	-	54.00
TOTALS	$1,324.45	$ 320.00	$1,104.45	$1,153.32[1]	$ 159.30	$ 994.02	$ 979.00[2]	$ 500.00	$ 479.00

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1 This stipulated amount varies from the $1,778.00 claimed by petitioners on their 1977 tax return.

2 This total varies from the stipulations by $1.00.

For the years 1976 through 1978, petitioners claimed and respondent disallowed deductions for medical expenses as shown on Schedule 5:

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SCHEDULE 5

MEDICAL EXPENSES

	1976			1977			1978		
	Amount Claimed	Amount Allowed	Amount Disallowed	Amount Claimed	Amount Allowed	Amount Disallowed	Amount Claimed	Amount Allowed	Amount Disallowed
INSURANCE:	$ 300.00	$ 61.74	$ 238.26	$ 183.48	$ 118.85	$ 64.63	$ 554.15	$ 554.15	$ -
DOCTORS & HOSPITALS:	2,434.00	2,436.45	-	1,427.80	1,634.31	-	890.50	898.50	-
DRUGS:	1,152.00	1,559.08	-	1,595.29	1,388.45	206.84	1,037.56	1,037.56	-
OTHERS:									
Transportation to and from Doctors and Hospitals	152.00	-	152.00	384.20	-	384.20	-	-	-
Glasses	-	-	-	76.38	76.38	-	88.93	88.93	-
Ambulance Service	-	-	-	98.62	-	98.62	-	-	-

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(4) Capital Loss Deductions and Carryovers

On their 1972 Federal tax return petitioners claimed a $5,000 long-term capital loss carryover from years beginning before 1970, a $1,200 short-term capital loss carryover from years beginning before 1970, and a $1,793 short-term capital loss resulting from a 1972 nonbusiness bad debt due from Charles Licavoli. The 1972 return was examined by an agent of respondent, who made small changes in petitioners' deductions for business expenses, depreciation and medical expenses. No changes were made to the $1,793 bad debt claimed in 1972 or to any of the capital loss carryovers. The net result of the audit for 1972 was a net adjustment of $319.97 in favor of petitioners.

On their 1973, 1974 and 1975 tax returns petitioners claimed and respondent disallowed deductions for capital losses carried over from prior years. To substantiate these deductions, petitioners rely on respondent's report of audit changes for 1972.

On their 1976 return, petitioners claimed a nonbusiness bad debt due from "Robt. Reeves" in the amount of $12,017. From this amount petitioners deducted and respondent disallowed $1,000 in 1976; $2,000 in 1977; and $3,000 in 1978.

(5) Investment Tax Credits

On their 1976, 1977 and 1978 tax returns, petitioners claimed investment tax credits for section 38 property in the respective amounts of $937.00, $382.00 and $257.42. A portion of

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Sometime later Ms. Wiseman made a third request to see the 1973 records. At this point Mr. Neece turned the audit over to his attorney, Edward R. Joyce, and the matter apparently remained at a standstill until in 1975 when the audit was expanded to include 1974 and 1975 and the examination was transferred from Ms. Wiseman to Revenue Agent Dave Crawford. Upon receipt of the assignment, Mr. Crawford attempted to examine petitioners' records for all three years. When his efforts proved to be unsuccessful, he attempted to close out the examination with the information then available but the case was returned to him after representations were made by Mr. Joyce that petitioners' records would be made available.

When the records were not made available, Mr. Crawford issued an administrative summons on February 7, 1978. In response to the summons, Mr. Neece and Mr. Joyce appeared before Mr. Crawford with a box containing tax documents for 1973, 1974 and 1975. In their presence Crawford prepared, executed and delivered to Joyce a detailed receipt in which the documents were identified as cancelled checks, bank statements, tally sheets, travel and other expense records for the years under examination.

On July 20, 1979, Crawford checked the documents in his possession against his copy of the document receipt and finding none missing returned them to Joyce, who accepted the records without complaint and on Crawford's copy of the receipt acknowledged the return of all documents submitted for examination. At some later date, Mr. Neece picked up the records from Joyce's office and replaced them in storage.

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the credit taken in 1976 resulted from the purchase by Gay F. Neece of an automobile which petitioners concede was not used in a trade or business.

Petitioners have not identified any other item for which the credits were taken. Respondent has disallowed all of the investment credits.

(6) Loss of Records

Barbara Wiseman, an office auditor for respondent, requested a conference in her office with respect to petitioners' 1973 tax return. Mr. Neece and his accountant, H. Ray Rehder, were present. In their presence, Ms. Wiseman examined petitioners' 1973 tax records which had been brought to her office in a box. The records included checks, receipts, miscellaneous correspondence and a yellow legal pad containing a tally of petitioners' checks. At the conclusion of the conference, Ms. Wiseman returned the records to the box and gave it to Mr. Neece, who took it home with him.

Two months after the first conference, Ms. Wiseman contacted Mr. Rehder and requested to again examine petitioners' 1973 tax records. This time her request was limited to specific documents which included checks, bank statements and related items. Upon being informed of this request, Mr. Neece accumulated the necessary documents and delivered them to Ms. Wiseman's office. Two months later, Ms. Wiseman again returned the documents to Mr. Neece.

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taxpayer may alternatively satisfy the substantiation requirements by coming forward with 'corroborative evidence sufficient' to support his own statement containing specific information in detail as to each element of the expenditure, or such elements as have not been substantiated by adequate records." Sanford v. Commissioner, 50 T.C. at 829.

In this case petitioners admit that they do not have adequate records for 1973, 1974 and 1975 but claim that part of their records for these years were lost during the audit by respondent's agents. Petitioners apparently rely on section 1.274-5(c)(5) of the regulations for some measure of relief. That section provides that:

> Where the taxpayer establishes that the failure to produce adequate records is due to the loss of such records through circumstances beyond the taxpayer's control, such as destruction by fire, flood, earthquake, or other casualty, the taxpayer shall have a right to substantiate a deduction by reasonable reconstruction of his expenditures.

From the list of documents shown on the receipt prepared by Mr. Crawford in February 1978, it appears that petitioners had substantial records at that time for 1973, 1974 and 1975. However, from the record as a whole we are unable to conclude that such records were adequate within the meaning of section 274(d) or that the records were lost or misplaced by respondent's agents.

First, with respect to the adequacy of such records, it is noted that the records for 1973 were not sufficient to permit Ms. Wiseman to conclude her audit even though she examined them twice and had them in her possession for over two months. Secondly,

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Petitioners contend that some of their records for 1973, 1974 and 1975 are missing because of the negligent manner in which the records were handled by respondent's agents. Respondent denies any negligence with respect to the records and contends that all of the records were returned to petitioners or their counsel.

OPINION

(1) Automobile, Travel and Employee Business Expenses

(a) Automobile Expenses

In general, section 162(a) allows a deduction for all ordinary and necessary expenses paid or incurred by a taxpayer during the taxable year in carrying on a trade or business. This includes transportation expenses of an employee, which includes an employee's expenses of operating his automobile in connection with his employment. Section 62(2)(C); sections 1.62-1(c)(4) and 1.62-1(g), Income Tax Regs. The taxpayer, however, has the burden of proof with respect to the nature and amount of the deduction. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a). See section 1.162-17(c), Income Tax Regs.

For the years under consideration, the automobile expenses claimed by petitioners and the treatment of such expenses by respondent were as follows:

Year	Petitioners Claimed	Respondent Allowed	Respondent Disallowed
1973	$4,069.42	$2,528.55	$1,540.87
1974	4,602.18	1,709.52	2,892.66
1975	4,914.90	3,627.51	1,287.39
1976	4,195.94	1,635.85	2,560.09
1977	4,105.97	1,581.34	2,524.63
1978	1,193.52	214.11	979.41

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The record contains no evidence pertaining to additional deductions for automobile expenses except the self-serving and uncorroborated testimony of Mr. Neece to the effect that he washed his car an average of two times a week at a cost of approximately $1.50 to $2.00 per wash. Consequently, we are unable to find that petitioners are entitled to any deduction for automobile expenses in excess of those allowed by respondent.

(b) Travel and Employee Business Expenses

This issue involves the deductibility and substantiation of expenditures under sections 162(a) and 274(d). As stated before, section 162(a) generally allows a deduction for all ordinary and necessary expenses paid or incurred by a taxpayer in carrying on a trade or business. Whether an expenditure is business or personal or is ordinary and necessary are questions of fact on which the taxpayer has the burden of proof. Commissioner v. Heininger, 320 U.S. 467 (1943); Chapman v. Commissioner, 48 T.C. 358 (1967); Bennett's Travel Bureau, Inc. v. Commissioner, 29 T.C. 350 (1957).

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Section 274(d) provides in part:

> (d) Substantiation Required.--No deduction shall be allowed--
>
> (1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),
>
> (2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, or
>
> (3) for any expense for gifts,
>
> unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift. * * * [Emphasis added.]

With respect to deductions described in section 274(d), the taxpayer is required to substantiate each expenditure by either "adequate records" or other "sufficient evidence" and any deduction not substantiated in this manner will be disallowed. Sanford v. Commissioner, 50 T.C. 823, 828 (1968), affd. per curiam 412 F.2d 201 (2d Cir. 1969), cert. denied 396 U.S. 841 (1969).

Adequate records include "[a]n account book, diary, statement of expense or similar record * * * made at or near the time of the expenditure," and "documentary evidence * * * [such as invoices or receipts] which, in combination, are sufficient to establish each element of an expenditure." Section 1.274-5(c)(2), Income Tax Regs. In the absence of such records, "the

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the records for all three years were such that Mr. Crawford was unable to complete his examination in 18 months. Thirdly, and more important, with respect to the loss of the records, it is noted that when Mr. Crawford returned them to Mr. Joyce no question was raised as to any loss and Mr. Joyce acknowledged the return of all of the records turned over to Mr. Crawford. Finally, petitioners' evidence with respect to the loss is somewhat contradictory because Mr. Neece testified that the loss was first discovered shortly before trial, but the petitions contain allegations made two years earlier that the records were lost through the negligence of respondent's agents.

Under the circumstances outlined above, we are unable to determine whether the records were adequate within the meaning of section 274(a) or how and by whom they were lost. Furthermore, the unintentional loss of the records even by respondent's agents would not shift the burden of going forward with the evidence to respondent. American Police & Fire Foundation, Inc. v. Commissioner, 81 T.C. 699 (1983). Such a loss would merely permit the use of secondary evidence by petitioners to carry their burden of proof. Malinowski v. Commissioner, 71 T.C. 1120, 1125 (1979). The record, however, contains no evidence of any attempt by petitioners to reconstruct the cancelled checks, invoices and other documents that were allegedly lost. See Gizzi v. Commissioner, 65 T.C. 342, 346 (1975). It is also noted that petitioners' claim of lost records pertains only to the years

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1973, 1974 and 1975 and does not extend to the following three years. Nevertheless, their records for those years are no more adequate than those produced for 1973, 1974 and 1975.

We are unable to conclude, therefore, that under sections 162(a) and 274(a) petitioners are entitled to deduct any travel and employee business expenses in addition to those allowed by respondent on Schedule 2.

In addition to the foregoing, we also note that petitioners have failed to explain why the deductions for secretarial services, travel and entertainment which were disallowed by respondent were not included within Paramount's reimbursement policy. Reimbursable employee expenses for which no reimbursement is claimed do not constitute ordinary and necessary expenses under section 162(a). Kennelly v. Commissioner, 56 T.C. 936, 943 (1971), affd. without opinion 456 F.2d 1335 (2d Cir. 1972).

In support of the deduction for office and storage space in the home, petitioners have offered no specific evidence regarding the amount or the relationship of such space to the employment of Mr. Neece or to the use of the home, the pool and the watch dog for business purposes. Mr. Neece merely testified that in his opinion 25 percent of the house including the pool and the dog was devoted to business purposes. However, his testimony was vague, indefinite, uncorroborated and, to some extent, contradictory. For instance, the 25 percent of the house which was purportedly devoted to business included a garage built in 1972 which Mr. Neece testified was used entirely for business

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purposes between 1972 and 1976. However, his list of items stolen from the garage included a number of obviously personal items such as a lawn mower, bicycle, circular saw, tools, a wagon, swim fins and books on boating.

From the record before us we are unable to determine that any part of the home including the pool and the watch dog was devoted to business and therefore we are unable to sustain any of these deductions in excess of those allowed by respondent.

With respect to the items shown on Schedule 3 which petitioners deducted as "other business expenses" the record contains no evidence to refute respondent's findings and, therefore, his disallowance of these deductions is sustained.

(2) Casualty Losses

Under section 165(c)(3), an individual taxpayer may deduct losses of nonbusiness property arising from fire, storm, or other casualty, or from theft, to the extent that the loss from each such incident exceeds $100. The loss sustained is the difference between the fair market value of the property immediately before the casualty and its value immediately thereafter, not to exceed, however, the adjusted basis of the property. Helvering v. Owens, 305 U.S. 468, 471 (1939); Pfalzgraf v. Commissioner, 67 T.C. 784, 787 (1977). The burden of proof as to the amount and the deductibility of the loss is upon the taxpayer. Burnet v. Houston, 283 U.S. 223 (1931).

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All such evidence is totally unreliable and cannot be accepted as being any indication of the value of the stone on the date of the loss. Furthermore, the record contains no evidence as to Mrs. Neece's basis in the stone. In the absence of proof of basis, the casualty loss could not be computed even if we knew the value of the stone. Millsap v. Commissioner, 46 T.C. 751, 760 (1966), affd. without discussion of this issue, 387 F.2d 420 (8th Cir. 1968); Towers v. Commissioner, 24 T.C. 199, 239 (1955).

From the record before us, our findings with respect to basis are limited to the fact that the ring was owned at some time in the past by Mrs. Neece's mother and was transferred to Mrs. Neece by way of her father. There is no indication of how the transfers were made to Mrs. Neece's father or from him to Mrs. Neece whether by gift, inheritance or purchase. Consequently, we are unable to determine whether a casualty loss was incurred or, if so, the amount thereof and respondent's disallowance of the loss is sustained.[5]

(c) Water Damage

On their 1976 tax return, petitioners claimed a casualty loss deduction allegedly resulting from the breakage of water pipelines. However, at trial they produced no evidence in support of this issue and it is deemed abandoned by them.

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5 See Bowman v. Commissioner, T.C. Memo. 1979-432.

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(3) Charitable Contributions and Medical Expenses

For the years 1976, 1977 and 1978, the deductions claimed by petitioners for charitable contributions and the amounts thereof which were allowed and disallowed by respondent appear on Schedule 4. The same information with respect to petitioners' deductions for medical expenses is set out on Schedule 5. Here again, the record contains no evidence with respect to these items except the vague, uncorroborated testimony of Mr. Neece from which we are unable to determine or even reasonably estimate the amount, if any, of the correct amount of such deductions. Petitioners, therefore, have failed to carry their burden of proving that they are entitled to any deductions for contributions or medical expenses in excess of those allowed by respondent on Schedules 4 and 5. Welch v. Helvering, 290 U.S. 111 (1933).

(4) Capital Loss Deductions and Carryovers

(a) For 1973, 1974 and 1975

An individual taxpayer may carry over net capital losses sustained in one tax year to later tax years pursuant to section 1212(b). The taxpayer, however, has the burden of proving the incurrence of the capital losses and his entitlement to the deductions. Welch v. Helvering, supra.

In 1973, 1974 and 1975 petitioners claimed capital loss deductions carried over from prior years. The capital losses were identified as (1) a nonbusiness debt due from Charles Licavoli which became worthless in 1972, (2) a nonbusiness debt

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due from Tali Corporation that became worthless prior to 1970, and (3) stock in Tali Corporation that became worthless prior to 1970. Deductions for all three of the capital losses were taken by petitioners and allowed by respondent on the 1972 return even though other changes were made on the 1972 return.

For each of the years 1973, 1974 and 1975, respondent concedes the allowance of the capital loss carryovers attributable to the nonbusiness bad debt due from Charles Licavoli. He disallowed the carryovers from the other two capital losses for lack of substantiation.

In support of their other capital loss carryover deductions in 1973, 1974 and 1975, petitioners produced no evidence other than respondent's audit report for 1972 in which the carryovers were allowed. Respondent, however, is not estopped from raising an issue merely because he failed to do so in a previous year. Rose v. Commissioner, 55 T.C. 28, 31 (1970). See Massaglia v. Commissioner, 286 F.2d 258, 262 (10th Cir. 1961), affg. 33 T.C. 379 (1959); Ward v. Commissioner, 240 F.2d 184, 185 (6th Cir. 1957), affg. 25 T.C. 815 (1956); Lozoff v. United States, 266 F. Supp. 966, 971 (E.D. Wis. 1967), affd. 392 F.2d 875 (7th Cir. 1968).

Inasmuch as petitioners have failed to offer any proof substantiating the losses underlying the carryovers from years prior to 1972, respondent's disallowance of the capital loss carryovers except for the loss attributable to the debt due from Charles Licavoli is sustained. Welch v. Helvering, supra.

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(b) For 1976, 1977 and 1978

In 1976, 1977 and 1978, petitioners claimed capital loss deductions which they attributed to the worthlessness in 1976 of a nonbusiness debt due from a certain Robert Reeves. Respondent disallowed the deductions for lack of substantiation of the loss. Petitioners again bear the burden of proof. Welch v. Helvering, supra.

Petitioners offered no evidence with regard to the debt except vague, self-serving testimony by Mr. Neece to the effect that the debtor was discharged in bankruptcy and that petitioners received no distributions from the bankrupt estate. In an attempt to corroborate Mr. Neece's testimony petitioners produced a statement indicating that a certain Irma Reeves was discharged in bankruptcy on September 14, 1976.

In the absence of any evidence as to the nature and amount of the alleged debt and the bankruptcy of Robert Reeves, we have no basis for disagreeing with respondent's determination. Therefore, his disallowance of the capital loss deductions in 1976, 1977 and 1978 attributable to the debt due from Robert Reeves is sustained.

(5) Investment Tax Credits

Petitioners claimed and respondent disallowed investment tax credits in 1976, 1977 and 1978 under section 38.

Here again, petitioners offered no proof which tended to support their claims for investment credits and failed to identify the items on which the credits were taken except for an

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automobile purchased in 1976. However, they now concede that this automobile was not used in a trade or business and was therefore not section 38 property.

Respondent's disallowance of the investments is sustained because petitioners have failed to carry their burden of proof. Welch v. Helvering, supra.

(6) Negligence

Respondent determined that additions to tax are due from petitioners for 1976, 1977 and 1978 under section 6653(a) for negligence or the intentional disregard of applicable rules and regulations. Petitioners have the burden of proving that respondent's determination is incorrect. Bixby v. Commissioner, 58 T.C. 757, 791 (1972).

Petitioners offered no proof on this issue and have failed to address the same on brief. However, in view of the deductions which they claimed in 1976, 1977 and 1978 for capital losses which they made no attempt to prove and their attempt to claim investment credits on assets not used in a trade or business, it is apparent that they were negligent to say the least in the preparation of their returns for these years. Consequently, respondent's determination with respect to the additions to tax is sustained.

To reflect the foregoing as well as the concessions made by the parties,

Decisions will be entered under Rule 155.

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(a) Theft of Personal Property

The parties agree that a theft of property occurred for which a casualty loss is deductible in 1973 under section 165(c)(3). They disagree as to the amount of the deduction.

Petitioners contend that their total loss is equal to the difference between the replacement cost of the stolen items ($9,241.74) less the amount received from their insurance company ($8,485.73). Respondent contends that their total loss is the difference between the fair market value of the property ($8,985.73) less the amount received from the insurance company. We agree with respondent. See Hernandez v. Commissioner, 72 T.C. 1234, 1240 (1979).

(b) Loss of Black Opal Stone

Respondent does not dispute that Mrs. Neece's black opal stone disappeared in Las Vegas, Nevada, on May 17, 1974. He merely argues that petitioners have failed to prove the amount of the loss or that the loss was the result of a casualty.

In support of the $5,000 deduction claimed as a result of the loss of the stone, petitioners produced an appraisal in the amount of $1,500. The appraisal was made by a jewelry store approximately seven years before the loss and covered not only the stone but the entire ring which also included, in addition to the stone, 14 sapphires and 26 diamond chips. At trial, Mr. Neece also offered by way of hearsay certain information regarding the stone's value which he allegedly gained from unnamed jewelers and his father-in-law.

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section 6653(a)(2) in an amount equal to 50 percent of the interest due on a deficiency of $2,238.87.[3] The issues for decision in this case are (1) whether petitioner Andrew J. Duncan's stock in Jamaica Pre-Mix, Ltd. became totally worthless during 1981; (2) whether petitioners are entitled to partnership losses in excess of the amount allowed by respondent with respect to the Paragon 80-2, Ltd. partnership; and (3) whether petitioners are liable for additions to tax under sections 6653(a)(1) and (2).

Petitioners Andrew J. Duncan (hereinafter referred to as petitioner) and Jo Anne J. Duncan, husband and wife, resided within the state of Florida at the time their petition was filed. Petitioners timely filed their 1981 joint Federal income tax return. On April 19, 1982, petitioners filed an amended return and claimed a long-term capital loss in the amount of $42,500 with respect to an investment in stock of Jamaica Pre-Mix, Ltd. A second amended return was filed by petitioners in which they claimed partnership losses in the amount of $14,314.[4] In the

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[3] We granted respondent's motion at trial to increase the income tax deficiency and the additions to tax in this case based solely upon mathematical errors in the statutory notice of deficiency. The income tax deficiency at issue, therefore, is $5,360.01, and the amounts of the additions to tax at issue under sections 6653(a)(1) and (2) are increased accordingly. Petitioners did not contest respondent's motion for increased deficiency.

[4] Petitioners' second amended return actually reflected a loss of $13,072 which resulted from the netting by petitioners of certain separately stated items on the partnership return totaling $14,314 against items overstated on their original return.

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statutory notice of deficiency respondent disallowed the long term capital loss on the grounds that there had been no disposition of petitioner's stock nor had it become worthless during the 1981 tax year. With regard to the partnership losses, respondent disallowed $2,270 on the ground that the claimed loss exceeded petitioner's adjusted basis in the Paragon 80-2, Ltd. partnership by such an amount.

Certain facts have been stipulated by the parties and are incorporated herein by this reference.

Jamaica Pre-Mix, Ltd.

Jamaica Pre-Mix, Ltd. (JPM) is a closely held family-run company formed under Jamaican law in 1958. During the year in issue approximately 75 percent of JPM's stock was held by Ledgehill International, a company owned 100 percent by petitioner's father; petitioner owned approximately 11 percent of JPM; and the remaining 14 percent was held by an unrelated investor. Since its formation JPM has been engaged in the production of pre-mixed concrete, sand and gravel for sale to the local Jamaican construction industry. JPM has operated continuously since 1958 and was still in operation at the time of trial in this case.

Petitioner was employed as the managing director of JPM from the time of its formation through 1969. It appears that JPM was, for the most part, profitable during this time span. In 1969

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petitioners left Jamaica due to political unrest and increasing violence. Since that time petitioner's brother has acted as managing director of JPM.

Due largely to the same conditions which precipitated petitioners' departure from Jamaica, the Jamaican economy (including its construction industry) suffered a marked decline during the 1970's. During this period JPM sustained a series of losses due to a substantial decrease in its sales. Petitioner contends that such losses, considered in conjunction with a number of other factors, prove that his JPM stock was worthless and that he is entitled to claim a loss therefor in 1981. Respondent contends that petitioner has failed to prove that his stock became worthless in 1981 and is thus not entitled to a deductible loss under section 165(g).[5]

A loss from worthless stock is treated under section 165(g) as a loss from the sale or exchange of the security on the last day of the taxable year in which worthlessness occurs. Section 1.165-1(d)(1), Income Tax Regs. provides in part that "a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions

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5 Section 165(g) provides, in pertinent part:
(g) Worthless Securities.--
(1) General Rule.--If any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset.
(2) Security Defined.--For purposes of this subsection, the term "security" means--
(A) a share of stock in a corporation; ***

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and as fixed by identifiable events occurring in such taxable year." The burden is on the taxpayer to establish the worthlessness of the stock and the year in which it became worthless. Boehm v. Commissioner, 326 U.S. 287, 292 (1945). Stock becomes worthless and the loss is sustained only when the stock has no liquidating value and there is no reasonable hope and expectation that at some future point in time it will become valuable. The loss of potential value can be established satisfactorily only by some "identifiable event" in the corporation's life which extinguishes all hope and expectation of revitalization, such as bankruptcy, cessation of business operations, liquidation of the corporation or appointment of a receiver for it. See Morton v. Commissioner, 38 B.T.A. 1270, 1278 (1938), affd. 112 F.2d 320 (7th Cir. 1940). Loss of potential value can also be inferred, in exceptional circumstances, where a corporation's liabilities so greatly exceed its assets and "the nature of its assets and business is such that there is no reasonable hope and expectation that a continuation of business will result in any profit to its stockholders." 38 B.T.A. at 1279. In such cases the stock clearly has no liquidating value and its worthlessness is established. The occurrence in a later year of an "identifiable" event, such as bankruptcy or liquidation, therefore, does not then determine the worthlessness of the stock in such circumstances.

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Petitioner does not contend that any "identifiable event" occurred during 1981 which would mark it as the year his JPM stock became worthless, and the record in this case reveals no such event. Petitioner, instead, points to a number of factors which cumulatively caused him in 1981 to give up hope that his stock had any value, including JPM's string of losses, the failure of the company to pay any dividends since its formation, his inability to sell his stock despite repeated attempts since 1969, the fact that he held a minority interest in JPM, as well as myriad economic and political problems. "I just concluded," petitioner testified, "that if it took seven years to declare a person dead, after 23 years I would declare my stock dead."

The only evidence in the record regarding JPM's liquidation value consists of audited financial statements for the year ended December 31, 1980, which reflect assets of J$2,862,543,[6] liabilities in the amount of J$1,640,207 and a resulting net worth of J$1,222,336. Petitioner claims that such figures are grossly inaccurate and that after making certain adjustments JPM's net worth as of December 31, 1980, would be more accurately estimated at (J$308,037).

Based upon this record we find that petitioner has failed to prove his stock became worthless during the year in issue. Petitioner has presented no evidence regarding the net worth of JPM in 1981, other than his unsubstantiated testimony that it further declined in that year. Even if we accept petitioner's

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6 Jamaican dollars are designated "J$."

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assertions regarding JPM's net worth for 1980 and 1981, we are still unable to find that petitioner's stock lacked potential value in such years since it is clear from the record that JPM has never ceased operations. Petitioner testified that JPM has maintained enough viability to provide his brother with his primary source of livelihood during the year in issue and beyond. It appears that JPM remains in a position to profit, and thus its shareholders would benefit from improvement in the Jamaican economic and political situation. Petitioners have failed to prove, therefore, that JPM had no potential value in 1981. Morton v. Commissioner, supra at 1278. Moreover, there is no evidence which would point to 1981 as a year in which future prospects for JPM became any more or less dismal than they had appeared to be in 1978, 1979 or 1980. The fact that petitioners gave up hope in 1981 is not determinative since the test for worthlessness of corporate stock is objective rather than subjective. Boehm v. Commissioner, supra at 290. Accordingly, respondent is sustained on this issue.

Partnership Losses.

Petitioners have presented no evidence or argument regarding the Paragon 80-2, Ltd. partnership losses. Respondent's determination as set forth in the notice of deficiency is presumed to be correct, with petitioners bearing the burden of proof. Rule 142(a); Welch v. Helvering, 290 U.S. 111 (1933). Since petitioners have clearly not met their burden of proof, we hold for respondent on this issue.

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Additions to Tax.

The remaining issue concerns respondent's determination that petitioners are liable for additions to tax under section 6653(a)(1) for "negligence or intentional disregard of rules or regulations" and under section 6653(a)(2) in an amount equal to 50 percent of the interest payable with respect to that part of the underpayment resulting from such negligence or intentional disregard of rules or regulations. The statutory notice of deficiency is unclear as to whether these additions were determined with respect to the worthless stock loss or the claimed partnership losses, but respondent argues on brief only with respect to the worthless stock issue. Once again, the burden of proof is on petitioners. Enoch v. Commissioner, 57 T.C. 781 (1972).

On this record, we find that petitioners have met their burden of proof and that no additions to tax under section 6653(a) should be imposed.

The primary adjustment to petitioners' 1981 income was the disallowance of a loss for worthless stock. The questions of worthlessness and the timing of such deductions have been litigated numerous times in years past, with each case ultimately turning on its own peculiar facts and circumstances. See, e.g., Scifo v. Commissioner, 68 T.C. 714 (1977).

Respondent makes much of the fact that petitioners attempted to claim a deduction for partial worthlessness of their JPM stock in 1978 and that they failed to seek tax advice prior to

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deducting it on their 1981 amended tax return. In Young v. Commissioner, 123 F.2d 597 (2d Cir. 1941), affg. a Memorandum Opinion of this Court, the court said at page 600:

> the taxpayer is at times in a very difficult position in determining in what year to claim a loss. The only safe practice, we think, is to claim a loss for the earliest year when it may possibly be allowed and to renew the claim in subsequent years if there is any reasonable chance of its being applicable to the income for those years.

In cases where difficult questions of law or fact are decided against taxpayers who in good faith took erroneous positions, we have previously held the addition to tax for negligence inapplicable. Dillin v. Commissioner, 56 T.C. 228, 248 (1971); Pederson v. Commissioner, 14 B.T.A. 1089, 1120 (1929). Based on this record we find that petitioners claimed the stock loss based upon their good faith interpretation of the facts as they knew them. Petitioners' inability to carry their burden of proof regarding the worthlessness of the stock does not, in this case, indicate that they were negligent in claiming the loss.

Petitioners did not contest respondent's other adjustments regarding partnership losses for the year 1981. These adjustments were minor, however, in comparison to the claimed stock loss, and were fully disclosed when first claimed in petitioners' second amended return. Such relatively minor adjustments do not rise to the level of what is considered to be negligence under section 6653(a). Compare Kilborn v.

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Commissioner, 29 T.C. 102, 111-112 (1957).[7] We, therefore, hold for petitioner with respect to the additions to tax under sections 6653(a)(1) and (2).

Decision will be entered under Rule 155.

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[7] See also King v. Commissioner, T.C. Memo. 1983-148, where the taxpayer did not dispute certain relatively minor adjustments to income made by respondent in the notice of deficiency, and the Court declined to apply the negligence penalty based upon such adjustments.

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T. C. Memo. 1986-122

UNITED STATES TAX COURT

ANDREW J. and JO ANNE J. DUNCAN, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 31773-84. Filed March 26, 1986.

Andrew J. and Jo Anne J. Duncan, pro se.

John Weeda, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

PETERSON, Special Trial Judge: This case was assigned pursuant to the provisions of section 7456(d)[1] and Rules 180, 181 and 182.[2]

In his statutory notice of deficiency dated June 7, 1984, respondent determined a deficiency in petitioners' 1981 Federal income tax in the amount of $2,238.87, an addition to tax under section 6653(a)(1) of $111.94 and an addition to tax under

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1 Statutory references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

2 All rule references are to the Tax Court Rules of Practice and Procedure.

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T.C. 1111 (1983); Nappi v. Commissioner, 58 T.C. 282 (1972); Dimmers v. Commissioner, T.C. Memo. 1986-35; Fedele v. Commissioner, T.C. Memo. 1985-569.

Petitioner refused to testify at trial as to the amount of remuneration received and presented no other evidence to establish error in the Commissioner's determination.[5] Accordingly, we find that respondent's determination is correct. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142.

We further hold that the additions to tax were properly imposed. Petitioner presented no evidence of the absence either of negligence or disregard of the rules. Petitioner failed to file a return in 1982, and has failed to carry his burden of proof in any other respect as to the additions to tax.

Finally, we find that damages under section 6673 should be imposed in the amount of $1,000.[6] At trial, petitioner merely

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[5] Petitioner claimed his Fifth Amendment privilege, even after respondent's counsel represented that no criminal proceedings were pending or, as far as she knew, were contemplated against petitioner. Under the instant circumstances, a Fifth Amendment privilege claim is completely unjustified and does not relieve petitioner of his burden of proof. See McCoy v. Commissioner, 76 T.C. 1027, 1029 (1981), affd., 696 F.2d 1234 (9th Cir. 1983); cf. Wilkinson v. Commissioner, 71 T.C. 633, 640-643 (1979); Hatfield v. Commissioner, 68 T.C. 895, 898 (1977).

[6] Petitioner contended that damages should not be imposed under sec. 6673 because petitioner did not argue "the taxability of wages--wages v. income" at trial, and that respondent represented to petitioner that a motion for damages would be made "if" that argument were made at trial. We find that respondent did not limit his ability to move for damages by this representation, and note, in any event, that we may impose damages sua sponte. Furthermore, at trial petitioner stated that "I did not earn any wages * * *." We do not find this argument (footnote continued)

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reiterated tax protester arguments that this Court has summarily rejected and has consistently found to be frivolous.[7] Additionally, petitioner presented no evidence and refused to testify as to the amount of remuneration he received. See Lukovsky v. Commissioner, 734 F.2d 1320 (8th Cir. 1984). Petitioner has abused the processes of this Court. We note that petitioner has tried a similar line of argument in the United States District Court, with a similar result.[8]

Accordingly,

Decision will be entered under Rule 155.

(footnote continued from previous page)
to be distinguishable from the argument that wages are not income.

[7] Respondent notified petitioner several times before trial that petitioner's contention that remuneration received by petitioner was not taxable was a frivolous argument and had been rejected consistently by this Court. Petitioner was also aware that damages may be awarded against him if he chose to pursue this line of argument at trial.

[8] See Ekblad v. Smith, Memorandum Opinion and Order, Civil No. 4-84-97 (D. Minn. May 29, 1985) (dismissing Ekblad's complaint with prejudice, and granting defendants' motion for summary judgment and motion to dismiss, and the subsequent Clerk's Notice under Rule 77(d), Fed. R. Civ. P., awarding defendants $300 for attorney fees, where Ekblad alleged that defendants conspired to withhold state and Federal tax from his wages against his will, depriving him of property without due process of law).

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T. C. Memo. 1986-123

UNITED STATES TAX COURT

DAVID EKBLAD, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 40730-84. Filed March 26, 1986.

David Ekblad, pro se.

Barbara A. Olson, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GERBER, Judge: Respondent determined deficiencies in and additions to petitioner's Federal income tax for his 1982 taxable year as follows:

	Additions to Tax			
Deficiency	§6651(a)	§6653(a)(1)	§6653(a)(2)	§6654
$1,375	$344	$69	50% of the interest due on $1,375	$134

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The deficiency was based upon petitioner's failure to file an income tax return for 1982 and report income in the amount of $10,657. Respondent has also made a motion for damages under section 6673.[1]

The issues for decision are: (1) Whether this Court has jurisdiction to hear the case; (2) whether petitioner received wage income which he failed to report; (3) whether the additions to tax are proper; and (4) whether damages should be imposed under section 6673 and, if so, to what extent.[2]

David Ekblad (petitioner) failed to file an income tax return for 1982. During that year petitioner was employed by the State of Minnesota.

On September 14, 1984, respondent mailed a notice of deficiency to petitioner at his Route 3, Box 100, Blooming Prairie, Minnesota 55917, address (Route 3 address). At the time of filing of his petition, petitioner listed his residence as 1117 First Street, N.E., Faribault, Minnesota 55021 (First Street address). Petitioner actually received the notice of deficiency and timely filed a petition with this Court.

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1 All section references are to the Internal Revenue Code of 1954, as amended and in effect during the taxable year at issue. All rule references are to the Tax Court Rules of Practice and Procedure.

2 At trial, respondent conceded that petitioner is entitled to an additional exemption for a child born in 1982. Petitioner is not entitled to an additional exemption for his wife, since petitioner's wife earned income during the year at issue. See sec. 151(b).

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provide the taxpayer with actual notice of the deficiency in a timely manner and afford him the opportunity to petition this Court for a redetermination of the deficiency. Clodfelter v. Commissioner, 527 F.2d at 756; Boren v. Riddell, supra at 672; Mulvania v. Commissioner, 81 T.C. at 68; Lifter v. Commissioner, 59 T.C. 818 (1973).

Petitioner was timely notified of the determined deficiency and has perfected an opportunity to litigate the deficiency before any payment of the same. Therefore, we hold that this Court has jurisdiction.[4]

Petitioner filed several other motions at trial questioning this Court's jurisdiction and made arguments on brief, in pretrial papers, and at trial pertaining to the taxability of remuneration received by him from the State of Minnesota. Included among these were claims that petitioner "did not earn any wages," that petitioner's wages were an "equal exchange for labor," that petitioner performed no act such as to make him a "taxpayer" or a "person [as] defined in the Internal Revenue Code," that the Administrative Procedure Act applied, etc. We have heard these tax protester arguments in a number of cases, and find them devoid of merit. We need say no more. See Abrams v. Commissioner, 82 T.C. 403 (1984); Rowlee v. Commissioner, 80

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[4] We orally denied petitioner's motion to dismiss for lack of jurisdiction on Sept. 9, 1985.

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On September 13, 1984, the District Office that mailed the notice to petitioner's Route 3 address received, by certified mail, correspondence which listed petitioner's address as the First Street address. Prior to the date of the mailing of the notice of deficiency, additional correspondence had been sent to and received by petitioner at the First Street address.

Petitioner seeks to have the determined deficiency dismissed on the ground that the notice is invalid because respondent did not mail it to his last known address, as prescribed by section 6212(b). Respondent contends that the notice of deficiency was mailed to petitioner's last known address, and that, in any event, petitioner's actual receipt of the notice coupled with his timely filing of the petition overcomes the jurisdictional hurdle. We agree with respondent's latter contention.[3]

The jurisdiction of this Court is wholly statutory. Section 6212(b)(1) provides that a notice shall be sufficient if it is mailed to the taxpayer at his "last known address." This Court and others have examined the role of section 6212(b)(1) within the statutory scheme in determining the congressional meaning of the phrase. See, e.g., Clodfelter v. Commissioner, 527 F.2d 754 (9th Cir. 1975), cert. denied 425 U.S. 979 (1976), affg. 57 T.C. 102 (1971); Boren v. Riddell, 241 F.2d 670 (9th Cir. 1957); Mulvania v. Commissioner, 81 T.C. 65 (1983); Frieling v. Commissioner, 81 T.C. 42 (1983). Section 6212 is intended to

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[3] We, therefore, need not decide the question whether the Route 3 address is petitioner's "last known address."

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T. C. Memo. 1986-124

UNITED STATES TAX COURT

WILLIAM K. JORDAN and BETTY JORDAN, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 33262-84. Filed March 26, 1986.

Brice A. Tondre, for the petitioners.

Gary R. Alonzo, for the respondent.

MEMORANDUM OPINION

GOFFE, Judge: This case is before us on petitioners' motion for summary judgment.

The Commissioner determined deficiencies in petitioners' income tax liabilities for the taxable years 1976, 1977, and 1978 as follows:

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Taxable Year	Deficiency	Additions to Tax Sec. 6651(a)(1)[1]	Sec. 6653(a)(1)
1976	$15,308.79	$2,005.54	$ 765.44
1977	9,000.63	2,149.48	533.93
1978	24,555.28	6,138.82	1,289.16

In their petition in this case, petitioners alleged that the deficiencies determined by the Commissioner were erroneous because the applicable period of limitations had expired prior to the issuance of the statutory notice of deficiency. Subsequently we granted petitioners' motion to sever the limitations issue for separate trial. As a result petitioners' present motion pertains only to the limitations issue and our ruling will be limited to that extent.

A hearing on petitioners' motion was held in Houston, Texas. At that time, the parties submitted a stipulation of facts. We have accepted the stipulated facts and incorporate them in our opinion.

Petitioners filed joint Federal income tax returns for the taxable years 1976, 1977, and 1978 with the Internal Revenue Service Center in Austin, Texas, on June 27, 1978, August 31, 1979, and August 30, 1979, respectively. In August 1979, petitioners were contacted for the first time by a revenue agent of the Examination Division of the Internal Revenue Service (I.R.S.) regarding an audit of their return for 1976. Subsequent to this initial contact, the audit of petitioners' return was

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[1] All section references are to the Internal Revenue Code of 1954, as amended, and all Rule references are to this Court's Rules of Practice and Procedure.

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reassigned to Revenue Agent Oscar Cantu (Agent Cantu) in November 1979. In early January 1980, Agent Cantu met with Mrs. Jordan concerning the audit of petitioners' 1976 return. Later, Agent Cantu expanded his audit to include petitioners' returns for the taxable years 1977 and 1978.

In the course of his continuing audit of their returns, Agent Cantu requested that petitioners execute a Form 872, Consent Fixing Period of Limitation Upon Assessment of Tax, thereby consenting to allow the Commissioner additional time to assess a deficiency of income tax for the taxable year 1976. On February 23, 1981, petitioners delivered a signed Form 872 to respondent consenting to an assessment of any deficiencies, for the taxable year 1976 only, until June 27, 1982. Shortly thereafter, respondent signed the Form 872 executed by petitioners.

On April 1, 1981, petitioners for the first time signed a power of attorney indicating that they were represented by a certified public accountant concerning the audit of their returns for the taxable years 1976, 1977, and 1978.

In November 1981, Agent Cantu referred petitioners' case to the Criminal Investigation Division (C.I.D.) of the I.R.S. Special Agent Ronnie B. Washington (Special Agent Washington) was assigned to perform an investigation to determine if criminal tax charges should be brought against petitioners for the taxable years in issue. In accordance with I.R.S. policy the civil

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examination of petitioners' returns came to a virtual standstill during the pendency of the criminal investigation. However, on February 17, 1982, Agent Cantu mailed to petitioners a letter and copies of Form 872-A, Special Consent to Extend the Time to Assess Tax. The letter requested that petitioners execute the Forms 872-A, which would extend the time during which the Commissioner could assess a deficiency for the taxable years 1976, 1977, and 1978 until such time as the consent was terminated by any of certain specified events.

Sometime subsequent to the receipt of the February 17, 1982, letter from Agent Cantu, petitioners signed, but did not date, Forms 872-A covering each year in issue. However, petitioners did not return the Forms 872-A to the I.R.S. as the letter from Agent Cantu requested.

On the evening of May 6, 1982, Special Agent Washington, accompanied by another special agent, conducted an initial interview with Mrs. Jordan at petitioners' residence. Mr. Jordan was out of town at this time and was, therefore, unable to be present. During the interview the special agents informed Mrs. Jordan of her constitutional rights. At the conclusion of the interview with the special agents, Mrs. Jordan delivered over to them the Forms 872-A for the taxable years 1976, 1977, and 1978, that she and Mr. Jordan had previously signed. The consents were left undated.

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Respondent signed the Forms 872-A received from Mrs. Jordan on May 13, 1982. No copies of the executed consents were returned to petitioners.

On May 20, 1982, petitioners signed a power of attorney appointing Brice Tondre and Andrew W. Miller, attorneys, as their representatives regarding the taxable years in issue. On July 7, 1982, Andrew W. Miller telephoned Agent Cantu on behalf of petitioners. Agent Cantu informed petitioners' counsel that all of the books and records obtained in the course of the civil examination were then in the custody of Special Agent Washington. Agent Cantu also informed counsel that Special Agent Washington retained possession of the consents received during his interview with Mrs. Jordan on May 6, 1982. On the same day counsel wrote a letter to Special Agent Washington stating, in part:

> Mr. Cantu further informed me that you are in possession of Forms 872, Consent to Extend the Time to Assess [T]ax, which were executed by Mr. and Mrs. Jordan. You are hereby notified that we consider those forms to be null and void and we demand the immediate return of said forms.

The criminal investigation was subsequently terminated and the case referred back to the Examination Division. On June 27, 1984, the Commissioner issued a statutory notice of deficiency to petitioners for the taxable years in issue.

Under Rule 121 a party may move for summary judgment upon all or any part of the legal issues in controversy so long as there are no genuine issues of material fact. Rule 121(b). The

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burden of proving that there is no genuine issue of material fact is on the moving party. Adickes v. Kress & Co., 398 U.S. 144, 157 (1970); Espinoza v. Commissioner, 78 T.C. 412, 416 (1982).

The essence of petitioners' arguments regarding the period of limitations in support of this motion may be set forth as follows:

1. The letter from petitioners' counsel to Special Agent Washington was sufficient to terminate the consents given in the Forms 872-A signed by petitioners.

2. The solicitation of the consents by Agent Cantu during the pendency of the criminal investigation was improper so that the consents were void at the time they were given.

3. The consents were obtained during the interview with the special agents through duress and are, therefore, void.

Section 6501(a) provides the general rule that income tax shall be assessed within 3 years after the return was filed. However, section 6501(c)(4) provides that the period of limitations will not expire if the taxpayer and the Commissioner timely agree in writing to extend the time for assessement. The Commissioner has provided forms for this purpose, which include Forms 872 and 872-A.

Petitioners and respondent executed a facially valid Form 872 for the taxable year 1976. A Form 872 executed by all parties constitutes an agreement to allow the Commissioner to assess a deficiency of tax against taxpayers beyond the normal

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expiration of the period of limitations until the time decided upon by the parties and stated on the form. Prior to the time the original consent terminated by its own terms, petitioners signed and delivered to respondent Forms 872-A extending the time for assessment indefinitely not only for the taxable year 1976, but also the taxable years 1977 and 1978. Each type of consent represents basically a unilateral waiver of a defense by a taxpayer and does not constitute a contract. Piarulle v. Commissioner, 80 T.C. 1035, 1042 (1983). Contract principles are, however, helpful and appropriate in analyzing the validity of these consents. 80 T.C. at 1042.

The consent granted on Form 872-A may be terminated by either party by notifying the other party, in writing, of the intent to terminate or by the issuance by the Commissioner of a statutory notice of deficiency. Prior to 1979 no particular form or letter existed for the purpose of terminating the effectiveness of an executed Form 872-A. In that year the I.R.S. announced that henceforth Form 872-A consents could be terminated, other than by the issuance of a statutory notice of deficiency by the Commissioner, only by signing and mailing new Form 872-T in accordance with instructions contained on that form. Rev. Proc. 79-22, 1979-1 C.B. 563, superseding Rev. Proc. 71-11, 1971-1 C.B. 678.

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This Court recently considered a challenge similar to petitioners' in Grunwald v. Commissioner, 86 T.C. __ (Jan. 28, 1986). In that case we considered whether a letter from an I.R.S. appeals officer to counsel for the taxpayers was sufficient to terminate a Form 872-A consent. We concluded that the parties were bound by the explicit provisions for termination found in the Form 872-A signed by the taxpayers and the Commissioner. 86 T.C. __ at p. 7 of Slip Opinion. Because the only methods available to the Commissioner to terminate the consent under the terms of Form 872-A were the issuance of a statutory notice of deficiency or the execution and mailing of Form 872-T, the letter in question did not constitute a valid termination of the consent agreement. Cases decided before the introduction of Form 872-T, such as Johnson v. Commissioner, 68 T.C. 637 (1977), and Borg-Warner Corp. v. Commissioner, 660 F.2d 324 (7th Cir. 1981), revg. T.C. Memo. 1979-350, were found to be no longer on point. 86 T.C. __ at pp. 8-9 of Slip Opinion. Because the letter from petitioners' counsel to Special Agent Washington does not conform to the terms of the consents signed by petitioners, it cannot constitute termination of the consents.[2]

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[2] We recognize that the letter from petitioners' counsel to Special Agent Washington indicates that counsel believed petitioners had executed Forms 872, and not Forms 872-A. Our acknowledgment of counsel's apparent confusion does not change our opinion inasmuch as there is no provision whatsoever for the unilateral termination of the consent that has been granted for a set period of time on Form 872.

(footnote continued)

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Petitioners' second contention is that it was a violation of I.R.S. procedures for Agent Cantu to seek consents from petitioners after their case had been referred to the C.I.D. for a criminal investigation thereby rendering the consents invalid. This contention is meritless.

When a revenue agent, in the course of a civil examination of a taxpayer's returns, concludes that there exists the potential for criminal liability the case is promptly referred to the C.I.D. Although the criminal investigation predominates, the examination of the taxpayer's returns then becomes a joint civil and criminal investigation. Internal Revenue Manual (I.R.M.) sec. 4565.31(5). In the interest of administrative economy and to protect the criminal case, the civil examination is typically suspended. I.R.M. sec. 4231 (Tax Audit Guidelines for Internal Revenue Examiners, section 981). Nevertheless, while the C.I.D. is conducting a criminal investigation, the revenue agent's duties do not cease. He remains obligated to take "any action necessary to protect the interest of the Government with respect to the statutory period for assessment." I.R.M. sec. 4565.6(1). Where appropriate, the revenue agent shall solicit consents from taxpayers during the pendency of a criminal investigation by

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We also recognize that respondent did not return signed copies of the consents to petitioners. This is not required of respondent and is immaterial to our decision. Findlay v. Commissioner, 332 F.2d 620 (2d Cir. 1964), affg. in part and revg. in part on other issues 39 T.C. 580, 588 (1962).

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mail. I.R.M. sec. 4565.6(4). This is exactly what Agent Cantu did by his letter dated February 17, 1982. In short Agent Cantu solicited the execution of the Forms 872-A "by the book." There was no breach of I.R.S. procedures.[3]

In any event it is established that the failure to comply with I.R.M. requirements, which are merely directory and not mandatory, will not render the action of respondent invalid. United States v. Horne, 714 F.2d 206 (1st Cir. 1983).[4] Cf. Einhorn v. DeWitt, 618 F.2d 347, 349-350 (5th Cir. 1980).

Petitioners' final argument is that the period of limitation for assessing tax for the taxable years in issue has expired because the consents were delivered to the special agents under duress. Petitioners contend that Mrs. Jordan, understandably upset about the spectre of possible criminal prosecution, was deprived of her free will by the special agents' request for the consents she and her husband previously signed, but had not dated. They emphasize that at the time of this request Mrs.

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[3] The only point at which we can discern that Agent Cantu departed from published I.R.S. procedures was his failure to be present when Special Agent Washington solicited the consents from Mrs. Jordan during his initial interview. I.R.S. procedures provide for personal contact to obtain the consent only in extraordinary circumstances. I.R.M. sec. 4565.6(4). The revenue agent assigned to a case is to accompany the special agent during such an in-person solicitation of consents for the extension of the period to assess taxes. I.R.M. sec. 4565.6(4). Because this is not the alleged impropriety to which petitioners take exception in this case and, in light of our holding on this issue, we deem it to be of no consequence.

[4] See Bridges v. Commissioner, T.C. Memo. 1983-763; Tucker v. Commissioner, T.C. Memo. 1983-210.

Jordan had just been formally read her constitutional rights and argue that the special agents told her that it would be to her benefit to hand over the consents. Furthermore, neither Mr. Jordan nor petitioners' C.P.A., for whom petitioners had executed a power of attorney appointing him as their representative before the I.R.S., was present at this meeting.

We defined duress in Diescher v. Commissioner, 18 B.T.A. 353, 358 (1929), as follows:

> It is now well settled that if an act of one party deprives another of his freedom of will to do or not to do a specific act the party so coerced becomes subject to the will of the other, there is duress, and in such a situation no act of the coerced person is voluntary and contracts made in such circumstances are void because there has been no voluntary meeting of the minds of the parties * * *

In determining if an act is done under duress, we look to the subjective mental state of the actor. Stanley v. Commissioner, 81 T.C. 634, 638 (1983). In this regard we apply a uniform Federal standard instead of state law. Stanley v. Commissioner, supra.

Whether Mrs. Jordan delivered the signed consents to the special agents under duress presents a factual issue that we cannot resolve on the record before us. For this reason, petitioners' motion must be denied.

In summary, petitioners have presented three arguments in support of their motion for summary judgment. Only if we determine that, based on the record before us, none of these arguments presents any genuine issues of material fact regarding

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the expiration of the applicable period of limitations can we rule in petitioners' favor. We have determined that petitioners' first two arguments present no such question of material fact. However, the question of duress presented by petitioners' does present issues of fact that must be resolved at a trial of the severed limitations issue. Although we have serious doubts that petitioners can satisfy their burden of proving duress at trial based upon the pleadings and affidavits before us, such doubts do not enable us to refuse them their day in court with respect to an issue that is not clearly frivolous. Therefore, this case shall be restored to the general docket for trial without prejudice to either party to determine the question of whether the applicable period of limitations has expired.[5]

An appropriate order will be entered.

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[5] In accordance with Rule 121(c) our order denying petitioners' motion for summary judgment will specify that the facts and argument presented by petitioners with respect to their first and second arguments in support of this motion, that the letter from counsel to Special Agent Washington terminated the consents and that Agent Cantu violated I.R.S. policies by soliciting the consents after the case had been referred to C.I.D. and thereby rendering the consents void, are insufficient to show that the period of limitations had expired.

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